

Expedia, Inc.  
Form 10-Q  
July 30, 2010  
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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2010

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-51447

# EXPEDIA, INC.

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-2705720**  
(I.R.S. Employer

Identification No.)

**333 108<sup>th</sup> Avenue NE**

**Bellevue, WA 98004**

(Address of principal executive office) (Zip Code)

**(425) 679-7200**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares outstanding of each of the registrant's classes of common stock as of July 16, 2010 was:

|                                                   |                    |
|---------------------------------------------------|--------------------|
| Common stock, \$0.001 par value per share         | 258,894,054 shares |
| Class B common stock, \$0.001 par value per share | 25,599,998 shares  |

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**Expedia, Inc.**

**Form 10-Q**

**For the Quarter Ended June 30, 2010**

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**Table of Contents****Part I. Item 1. Consolidated Financial Statements****EXPEDIA, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

(Unaudited)

|                                                                                           | <b>Three months ended<br/>June 30,</b> |                  | <b>Six months ended<br/>June 30,</b> |                  |
|-------------------------------------------------------------------------------------------|----------------------------------------|------------------|--------------------------------------|------------------|
|                                                                                           | <b>2010</b>                            | <b>2009</b>      | <b>2010</b>                          | <b>2009</b>      |
| Revenue                                                                                   | \$ 833,960                             | \$ 769,768       | \$ 1,551,879                         | \$ 1,405,480     |
| Costs and expenses:                                                                       |                                        |                  |                                      |                  |
| Cost of revenue (1)                                                                       | 168,571                                | 148,762          | 326,601                              | 292,275          |
| Selling and marketing (1)                                                                 | 296,830                                | 271,492          | 577,668                              | 507,376          |
| Technology and content (1)                                                                | 87,420                                 | 77,881           | 174,211                              | 155,553          |
| General and administrative (1)                                                            | 79,105                                 | 67,380           | 150,163                              | 135,289          |
| Amortization of intangible assets                                                         | 8,344                                  | 9,302            | 17,372                               | 18,371           |
| Occupancy tax assessments and legal reserves                                              |                                        | 74,211           |                                      | 74,211           |
| Restructuring charges                                                                     |                                        | 6,098            |                                      | 14,816           |
| Operating income                                                                          | 193,690                                | 114,642          | 305,864                              | 207,589          |
| Other income (expense):                                                                   |                                        |                  |                                      |                  |
| Interest income                                                                           | 1,221                                  | 1,417            | 1,816                                | 4,088            |
| Interest expense                                                                          | (20,209)                               | (20,805)         | (41,412)                             | (42,450)         |
| Other, net                                                                                | 817                                    | (19,073)         | 1,385                                | (26,020)         |
| Total other expense, net                                                                  | (18,171)                               | (38,461)         | (38,211)                             | (64,382)         |
| Income before income taxes                                                                | 175,519                                | 76,181           | 267,653                              | 143,207          |
| Provision for income taxes                                                                | (60,166)                               | (34,338)         | (91,701)                             | (61,610)         |
| Net income                                                                                | 115,353                                | 41,843           | 175,952                              | 81,597           |
| Net income attributable to noncontrolling interests                                       | (1,091)                                | (941)            | (2,295)                              | (1,311)          |
| <b>Net income attributable to Expedia, Inc.</b>                                           | <b>\$ 114,262</b>                      | <b>\$ 40,902</b> | <b>\$ 173,657</b>                    | <b>\$ 80,286</b> |
| <b>Earnings per share attributable to Expedia, Inc. available to common stockholders:</b> |                                        |                  |                                      |                  |
| Basic                                                                                     | \$ 0.40                                | \$ 0.14          | \$ 0.61                              | \$ 0.28          |
| Diluted                                                                                   | 0.40                                   | 0.14             | 0.60                                 | 0.28             |
| <b>Shares used in computing earnings per share:</b>                                       |                                        |                  |                                      |                  |
| Basic                                                                                     | 284,088                                | 288,180          | 286,333                              | 287,764          |
| Diluted                                                                                   | 288,975                                | 290,889          | 291,726                              | 289,384          |
| Dividends declared per common share                                                       | \$ 0.07                                | \$               | \$ 0.14                              | \$               |

(1) Includes stock-based compensation as follows:

|                       |        |        |          |          |
|-----------------------|--------|--------|----------|----------|
| Cost of revenue       | \$ 487 | \$ 514 | \$ 1,276 | \$ 1,225 |
| Selling and marketing | 3,118  | 2,780  | 7,435    | 6,771    |

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|                                |           |           |           |           |
|--------------------------------|-----------|-----------|-----------|-----------|
| Technology and content         | 3,249     | 3,412     | 7,630     | 8,588     |
| General and administrative     | 7,797     | 6,870     | 17,202    | 15,564    |
| Total stock-based compensation | \$ 14,651 | \$ 13,576 | \$ 33,543 | \$ 32,148 |

See accompanying notes.

**Table of Contents****EXPEDIA, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share data)

|                                                                | <b>June 30,<br/>2010<br/>(Unaudited)</b> | <b>December 31,<br/>2009</b> |
|----------------------------------------------------------------|------------------------------------------|------------------------------|
| <b>ASSETS</b>                                                  |                                          |                              |
| Current assets:                                                |                                          |                              |
| Cash and cash equivalents                                      | \$ 795,854                               | \$ 642,544                   |
| Restricted cash and cash equivalents                           | 16,349                                   | 14,072                       |
| Short-term investments                                         | 331,286                                  | 45,849                       |
| Accounts receivable, net of allowance of \$14,030 and \$14,562 | 390,685                                  | 307,817                      |
| Prepaid merchant bookings                                      | 157,053                                  | 88,971                       |
| Prepaid expenses and other current assets                      | 124,464                                  | 125,796                      |
| Total current assets                                           | 1,815,691                                | 1,225,049                    |
| Property and equipment, net                                    | 257,012                                  | 236,820                      |
| Long-term investments and other assets                         | 152,099                                  | 48,262                       |
| Intangible assets, net                                         | 801,328                                  | 823,031                      |
| Goodwill                                                       | 3,596,764                                | 3,603,994                    |
| <b>TOTAL ASSETS</b>                                            | <b>\$ 6,622,894</b>                      | <b>\$ 5,937,156</b>          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                    |                                          |                              |
| Current liabilities:                                           |                                          |                              |
| Accounts payable, merchant                                     | \$ 792,053                               | \$ 652,893                   |
| Accounts payable, other                                        | 211,131                                  | 160,471                      |
| Deferred merchant bookings                                     | 1,260,631                                | 679,305                      |
| Deferred revenue                                               | 26,853                                   | 17,204                       |
| Accrued expenses and other current liabilities                 | 296,554                                  | 325,184                      |
| Total current liabilities                                      | 2,587,222                                | 1,835,057                    |
| Long-term debt                                                 | 895,374                                  | 895,086                      |
| Deferred income taxes, net                                     | 226,962                                  | 223,959                      |
| Other long-term liabilities                                    | 246,782                                  | 233,328                      |
| Commitments and contingencies                                  |                                          |                              |
| Stockholders' equity:                                          |                                          |                              |
| Preferred stock \$.001 par value                               |                                          |                              |
| Authorized shares: 100,000                                     |                                          |                              |
| Series A shares issued and outstanding: 1 and 1                |                                          |                              |
| Common stock \$.001 par value                                  | 347                                      | 343                          |
| Authorized shares: 1,600,000                                   |                                          |                              |
| Shares issued: 346,529 and 342,812                             |                                          |                              |
| Shares outstanding: 258,777 and 263,929                        |                                          |                              |
| Class B common stock \$.001 par value                          | 26                                       | 26                           |
| Authorized shares: 400,000                                     |                                          |                              |
| Shares issued and outstanding: 25,600 and 25,600               |                                          |                              |
| Additional paid-in capital                                     | 6,031,652                                | 6,034,164                    |
| Treasury stock - Common stock, at cost                         | (1,937,702)                              | (1,739,198)                  |
| Shares: 87,752 and 78,883                                      |                                          |                              |

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|                                                   |                     |                     |
|---------------------------------------------------|---------------------|---------------------|
| Retained earnings (deficit)                       | (1,442,376)         | (1,616,033)         |
| Accumulated other comprehensive income (loss)     | (46,013)            | 3,379               |
| Total Expedia, Inc. stockholders' equity          | 2,605,934           | 2,682,681           |
| Noncontrolling interest                           | 60,620              | 67,045              |
| Total stockholders' equity                        | 2,666,554           | 2,749,726           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> | <b>\$ 6,622,894</b> | <b>\$ 5,937,156</b> |

See accompanying notes.

**Table of Contents****EXPEDIA, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

|                                                                                                 | <b>Six months ended June 30,</b> |                  |
|-------------------------------------------------------------------------------------------------|----------------------------------|------------------|
|                                                                                                 | <b>2010</b>                      | <b>2009</b>      |
| <b>Operating activities:</b>                                                                    |                                  |                  |
| Net income                                                                                      | \$ 175,952                       | \$ 81,597        |
| Adjustments to reconcile net income to net cash provided by operating activities:               |                                  |                  |
| Depreciation of property and equipment, including internal-use software and website development | 55,930                           | 49,429           |
| Amortization of stock-based compensation                                                        | 33,543                           | 32,148           |
| Amortization of intangible assets                                                               | 17,372                           | 18,371           |
| Deferred income taxes                                                                           | 3,344                            | (7,112)          |
| Foreign exchange loss on cash and cash equivalents, net                                         | 39,334                           | 8,540            |
| Realized (gain) loss on foreign currency forwards                                               | 3,886                            | (29,957)         |
| Other                                                                                           | 11,534                           | 7,798            |
| Changes in operating assets and liabilities, net of effects from acquisitions:                  |                                  |                  |
| Accounts receivable                                                                             | (105,232)                        | (99,853)         |
| Prepaid merchant bookings, prepaid expenses and other current assets                            | (92,514)                         | (40,883)         |
| Accounts payable, merchant                                                                      | 143,504                          | 115,710          |
| Accounts payable, other, accrued expenses and other current liabilities                         | 54,343                           | 115,807          |
| Deferred merchant bookings                                                                      | 581,441                          | 589,298          |
| Deferred revenue                                                                                | 10,896                           | 3,657            |
| <b>Net cash provided by operating activities</b>                                                | <b>933,333</b>                   | <b>844,550</b>   |
| <b>Investing activities:</b>                                                                    |                                  |                  |
| Capital expenditures, including internal-use software and website development                   | (73,128)                         | (42,052)         |
| Purchases of investments                                                                        | (429,483)                        |                  |
| Sales and maturities of investments                                                             | 46,912                           | 45,091           |
| Acquisitions, net of cash acquired                                                              | (36,353)                         | (8,363)          |
| Distributions from Reserve Primary Fund                                                         | 5,482                            | 9,083            |
| Net settlement of foreign currency forwards                                                     | (3,886)                          | 29,957           |
| Other, net                                                                                      | (882)                            | 1,522            |
| <b>Net cash provided by (used in) investing activities</b>                                      | <b>(491,338)</b>                 | <b>35,238</b>    |
| <b>Financing activities:</b>                                                                    |                                  |                  |
| Credit facility repayments                                                                      |                                  | (650,000)        |
| Payment of dividends to stockholders                                                            | (40,122)                         |                  |
| Treasury stock activity                                                                         | (198,504)                        | (5,434)          |
| Proceeds from exercise of equity awards                                                         | 30,630                           | 567              |
| Purchase of additional interest in controlled subsidiary                                        | (24,717)                         |                  |
| Excess tax benefit on equity awards                                                             | 5,053                            | 13               |
| Changes in restricted cash and cash equivalents                                                 | (2,207)                          | (17,213)         |
| Other, net                                                                                      | (10,913)                         | (5,907)          |
| <b>Net cash used in financing activities</b>                                                    | <b>(240,780)</b>                 | <b>(677,974)</b> |
| Effect of exchange rate changes on cash and cash equivalents                                    | (47,905)                         | (4,932)          |



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|                                                   |                   |                   |
|---------------------------------------------------|-------------------|-------------------|
| <b>Net increase in cash and cash equivalents</b>  | 153,310           | 196,882           |
| Cash and cash equivalents at beginning of period  | 642,544           | 665,412           |
| <b>Cash and cash equivalents at end of period</b> | <b>\$ 795,854</b> | <b>\$ 862,294</b> |
| <b>Supplemental cash flow information</b>         |                   |                   |
| Cash paid for interest                            | \$ 38,336         | \$ 39,682         |
| Income tax payments, net                          | 46,135            | 99,303            |
| See accompanying notes.                           |                   |                   |

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**Notes to Consolidated Financial Statements**

**June 30, 2010**

**(Unaudited)**

**Note 1 Basis of Presentation**

***Description of Business***

Expedia, Inc. and its subsidiaries provide travel products and services to leisure and corporate travelers in the United States and abroad as well as various media and advertising offerings to travel and non-travel advertisers. These travel products and services are offered through a diversified portfolio of brands including: Expedia.com®, Hotels.com®, Hotwire.com™, TripAdvisor® Media Network, Expedia® Affiliate Network, Classic Vacations, Expedia Local Expert, Egencia™, Expedia® CruiseShipCenters®, eLong™, Inc. ( eLong ) and Venere Net SpA ( Venere ). In addition, many of these brands have related international points of sale. We refer to Expedia, Inc. and its subsidiaries collectively as Expedia, the Company, us, we and our in these consolidated financial statements.

***Basis of Presentation***

These accompanying financial statements present our results of operations, financial position and cash flows on a consolidated basis. The unaudited consolidated financial statements include Expedia, Inc., our wholly-owned subsidiaries, and entities we control, or in which we have a variable interest and are the primary beneficiary of expected cash profits or losses. We have eliminated significant intercompany transactions and accounts.

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial reporting. We have included all adjustments necessary for a fair presentation of the results of the interim period. These adjustments consist of normal recurring items. Our interim unaudited consolidated financial statements are not necessarily indicative of results that may be expected for any other interim period or for the full year. These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2009, previously filed with the Securities and Exchange Commission ( SEC ).

***Accounting Estimates***

We use estimates and assumptions in the preparation of our interim unaudited consolidated financial statements in accordance with GAAP. Our estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of our interim unaudited consolidated financial statements. These estimates and assumptions also affect the reported amount of net income during any period. Our actual financial results could differ significantly from these estimates. The significant estimates underlying our interim unaudited consolidated financial statements include revenue recognition; recoverability of current and long-lived assets, intangible assets and goodwill; income and indirect taxes, such as potential settlements related to occupancy taxes; loss contingencies; stock-based compensation and accounting for derivative instruments.

***Reclassifications***

We have reclassified certain amounts related to our prior period results to conform to our current period presentation.

***Seasonality***

We generally experience seasonal fluctuations in the demand for our travel products and services. For example, traditional leisure travel bookings are generally the highest in the first three quarters as travelers plan and book their spring, summer and holiday travel. The number of bookings typically decreases in the fourth quarter. Because revenue in our

**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

merchant business is generally recognized when the travel takes place rather than when it is booked, revenue typically lags bookings by several weeks or longer. As a result, revenue is typically the lowest in the first quarter and highest in the third quarter.

**Note 2 Summary of Significant Accounting Policies*****Recently Adopted Accounting Pronouncements***

On January 1, 2010, we adopted the new Financial Accounting Standards Board ( FASB ) guidance on the consolidation of variable interest entities. The new guidance requires revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. The adoption of this guidance did not materially impact our consolidated financial statements.

On January 1, 2010, we adopted the new FASB guidance that requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. The guidance was effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures that are effective for annual periods beginning after December 15, 2010. The adoption of this guidance did not materially impact our consolidated financial statements nor do we expect the adoption of the additional guidance surrounding Level 3 reconciliations to have a material impact on our consolidated financial statements in the future.

***New Accounting Pronouncements***

In October 2009, the FASB issued guidance on revenue recognition to require companies to allocate revenue in multiple-element arrangements based on an element's estimated selling price if vendor-specific or other third-party evidence of value is not available. This guidance is effective beginning January 1, 2011 with earlier application permitted. We are currently evaluating both the timing and the impact the adoption of this guidance will have on our consolidated financial statements.

**Note 3 Fair Value Measurements**

Financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2010 are classified using the fair value hierarchy in the table below:

|                                    | Total      | Level 1<br>(In thousands) | Level 2    |
|------------------------------------|------------|---------------------------|------------|
| Assets                             |            |                           |            |
| Cash equivalents:                  |            |                           |            |
| Money market funds                 | \$ 461,400 | \$ 461,400                | \$         |
| Investments:                       |            |                           |            |
| Time deposits                      | 257,210    |                           | 257,210    |
| Corporate debt securities          | 125,209    |                           | 125,209    |
| Bearer deposit note                | 32,794     |                           | 32,794     |
| Foreign currency forward contracts | 5,187      |                           | 5,187      |
| Total assets                       | \$ 881,800 | \$ 461,400                | \$ 420,400 |

**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

Financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 are classified using the fair value hierarchy in the table below:

|                                    | Total      | Level 1<br>(In thousands) | Level 2   |
|------------------------------------|------------|---------------------------|-----------|
| Assets                             |            |                           |           |
| Cash equivalents:                  |            |                           |           |
| Money market funds                 | \$ 313,480 | \$ 313,480                | \$        |
| Investments:                       |            |                           |           |
| Time deposits                      | 45,849     |                           | 45,849    |
| Foreign currency forward contracts | 680        |                           | 680       |
| Total assets                       | \$ 360,009 | \$ 313,480                | \$ 46,529 |

The levels of fair value hierarchy are described as follows:

**Level 1** Valuations based on quoted prices for identical assets and liabilities in active markets.

**Level 2** Valuations based on observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

**Level 3** Valuations based on unobservable inputs reflecting the Company's own assumptions, consistent with reasonably available assumptions made by other market participants. These valuations require significant judgment.

We classify our cash equivalents and investments within Level 1 and Level 2 as we value our cash equivalents and investments using quoted market prices or alternative pricing sources and models utilizing market observable inputs. Valuation of the foreign currency forward contracts is based on foreign currency exchange rates in active markets considered a Level 2 input.

As of June 30, 2010 and December 31, 2009, our cash and cash equivalents consisted primarily of prime institutional money market funds with maturities of 90 days or less as well as bank account balances.

During the first quarter of 2010, we began investing in investment grade corporate debt securities all of which are classified as available for sale and recorded at fair value with unrealized holding gains and losses recorded, net of tax, as a component of accumulated other comprehensive income. Available for sale securities with remaining maturities of less than one year are classified as short-term within short-term investments on the consolidated balance sheet; and all other available for sale securities with maturities ranging from one year to four years are classified as long-term within long-term investments and other assets on the consolidated balance sheet. As of June 30, 2010, we had \$41 million of short-term and \$84 million of long-term available for sale investments and the amortized cost basis of these investments approximated their fair value.

Beginning in the second quarter of 2010, our investments include a bearer deposit note, which is a discounted, tradeable note guaranteed by its issuing bank. The note is classified as held to maturity and recorded at amortized cost, and as it has a maturity of less than one year is classified as a short term investment on the consolidated balance sheet. The amortized cost basis of this investment approximated its fair value.

In addition, we hold time deposit investments with financial institutions with original maturities of greater than 90 days. As of June 30, 2010, \$257 million were included within short term investments and \$14 million within long term investments, and as of December 31, 2009, \$46 million were included in short term investments. Of the total time deposit investments, \$20 million related to balances held by our majority-owned subsidiaries as of June 30, 2010 and the entire balance at December 31, 2009 was held by our majority-owned subsidiaries.



**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

Derivative instruments are carried at fair value on our consolidated balance sheets. We use foreign currency forward contracts to economically hedge certain merchant revenue exposures and in lieu of holding certain foreign currency cash for the purpose of economically hedging our foreign currency-denominated operating liabilities. Our goal in managing our foreign exchange risk is to reduce, to the extent practicable, our potential exposure to the changes that exchange rates might have on our earnings, cash flows and financial position. Our foreign currency forward contracts are typically short-term and, as they do not qualify for hedge accounting treatment, we classify the changes in their fair value in other, net. As of June 30, 2010, we were party to outstanding forward contracts hedging our liability and revenue exposures with a total net notional value of \$152 million. We had net forward assets of \$5 million and \$1 million recorded in prepaid and other current assets as of June 30, 2010 and December 31, 2009. We recorded \$3 million in net losses and \$28 million in net gains from foreign currency forward contracts for the three months ended June 30, 2010 and 2009, and \$1 million and \$29 million in net gains for the six months ended June 30, 2010 and 2009.

**Note 4 Debt**

The following table sets forth our outstanding debt:

|                                             | June 30,<br>2010 | December 31,<br>2009 |
|---------------------------------------------|------------------|----------------------|
|                                             | (In thousands)   |                      |
| 8.5% senior notes due 2016, net of discount | \$ 395,374       | \$ 395,086           |
| 7.456% senior notes due 2018                | 500,000          | 500,000              |
| Long-term debt                              | \$ 895,374       | \$ 895,086           |

**Long-term Debt**

Our \$400 million of senior unsecured notes outstanding at June 30, 2010 are due in July 2016 and bear interest at 8.5% (the "8.5% Notes"). The 8.5% Notes were issued at 98.572% of par resulting in a discount, which is being amortized over their life. Interest is payable semi-annually in January and July of each year. The 8.5% Notes include covenants that limit our ability under certain circumstances to (i) incur additional indebtedness, (ii) pay dividends or make restricted payments, (iii) dispose of assets, (iv) create or incur liens, (v) enter into sale/leaseback transactions and (vi) merge or consolidate with or into another entity. Certain of these covenants in the 8.5% Notes, including the covenants limiting under certain circumstances our ability to incur additional indebtedness, pay dividends or make restricted payments and dispose of assets, will be suspended during any time that the 8.5% Notes have an investment grade rating from both Standard and Poor's and Moody's and no default exists under the 8.5% Note indenture. The 8.5% Notes are repayable in whole or in part upon the occurrence of a change of control, at the option of the holders, at a purchase price in cash equal to 101% of the principal plus accrued interest. Prior to July 1, 2011, in the event of a qualified equity offering, we may redeem up to 35% of the 8.5% Notes at a redemption price of 108.5% of the principal plus accrued interest. Additionally, we may redeem the 8.5% Notes prior to July 1, 2012 in whole or in part at a redemption price of 100% of the principal plus accrued interest, plus a "make-whole" premium. On or after July 1, 2012, we may redeem the 8.5% Notes in whole or in part at specified prices ranging from 104.250% to 100% of the principal plus accrued interest.

Our \$500 million in registered senior unsecured notes outstanding at June 30, 2010 are due in August 2018 and bear interest at 7.456% (the "7.456% Notes"). Interest is payable semi-annually in February and August of each year. The 7.456% Notes include covenants that limit our ability (i) to enter into sale/leaseback transactions, (ii) to create or incur liens and (iii) to merge or consolidate with or into another entity. The 7.456% Notes are repayable in whole or in part on August 15, 2013, at the option of the holders of such 7.456% Notes, at 100% of the principal amount plus accrued interest. We may redeem the 7.456% Notes at a redemption price of 100% of the principal plus accrued interest, plus a "make-whole" premium, in whole or in part at any time at our option.

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### **Notes to Consolidated Financial Statements (Continued)**

Based on quoted market prices, the fair value of our 7.456% Notes was approximately \$548 million and \$546 million as of June 30, 2010 and December 31, 2009, and the fair value of the 8.5% Notes was approximately \$429 million and \$431 million as of June 30, 2010 and December 31, 2009.

The 7.456% and 8.5% Notes are senior unsecured obligations guaranteed by certain domestic Expedia subsidiaries and rank equally in right of payment with all of our existing and future unsecured and unsubordinated obligations. For further information, see Note 11 Guarantor and Non-Guarantor Supplemental Financial Information. Accrued interest related to the 7.456% and 8.5% Notes was \$31 million at June 30, 2010 and December 31, 2009.

#### ***Credit Facility***

In February 2010, we entered into a new \$750 million, three-year unsecured revolving credit facility (the "facility") with a group of lenders, replacing our prior \$1 billion credit facility (the "prior facility"). The facility is unconditionally guaranteed by certain domestic Expedia subsidiaries, which are the same as under the 7.456% and 8.5% Notes. As of June 30, 2010, we had no borrowings outstanding under the facility and as of December 31, 2009, we had no borrowings outstanding under the prior facility. The facility bears interest based on the Company's credit ratings, with drawn amounts bearing interest at LIBOR plus 300 basis points and undrawn amounts bearing interest at 50 basis points as of June 30, 2010. The facility contains financial covenants consisting of a leverage ratio and a minimum interest coverage ratio. We incurred approximately \$8 million in fees associated with the facility, which will be amortized over its life of three years.

The amount of stand-by letters of credit ("LOC") issued under the facility reduces the credit amount available. As of June 30, 2010, and December 31, 2009, there was \$40 million (of which \$29 million related to the facility and \$11 million related to the prior facility) and \$42 million of outstanding stand-by LOCs issued under the respective facilities.

#### **Note 5 Stockholders' Equity**

##### ***Share Repurchases***

In 2006, our Board of Directors authorized a share repurchase of up to 20 million outstanding shares of our common stock. There is no fixed termination date for the repurchase. During the first half of 2010, we repurchased, through open market transactions, 8.4 million shares under this authorization for a total cost of \$188 million, representing an average repurchase price of \$22.46 per share. As of June 30, 2010, 11.6 million shares remain authorized for repurchase.

##### ***Dividends on our Common Stock***

In the first and second quarters of 2010, the Executive Committee, acting on behalf of the Board of Directors, declared and we paid quarterly cash dividends of \$0.07 per share of outstanding common stock payable to stockholders of record as of the close of business on March 11, 2010 and May 27, 2010. In addition, on July 26, 2010, the Executive Committee, acting on behalf of the Board of Directors, declared a quarterly cash dividend of \$0.07 per share of outstanding common stock to stockholders of record as of the close of business on August 26, 2010. Future declarations of dividends are subject to final determination by our Board of Directors.

##### ***Stock-based Awards***

Stock-based compensation expense relates primarily to expense for restricted stock units ("RSUs") and stock options. Our RSUs generally vest over five years and our stock options generally vest over four years.

As of June 30, 2010, we had stock-based awards outstanding representing approximately 25 million shares of our common stock consisting of options to purchase approximately 21 million shares of our common stock with a weighted average exercise price of \$17.23 and weighted average remaining life of 5.5 years and approximately 5 million RSUs.

Annual employee stock-based award grants typically occur during the first quarter of each year. In 2009, we began awarding stock options as our primary form of stock-based compensation. During the six months ended June 30, 2010, we granted 6 million stock options. During the six

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months ended June 30, 2009, we granted 10 million stock options and 1 million RSUs.



**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

The fair value of the stock options granted during the six months ended June 30, 2010 and 2009 was estimated at the date of grant using the Black-Scholes option-pricing model and totaled \$53 million and \$33 million.

**Comprehensive Income**

Comprehensive income attributable to Expedia, Inc. was \$88 million and \$77 million for the three months ended June 30, 2010 and 2009, and \$124 million and \$91 million for the six months ended June 30, 2010 and 2009. The primary difference between net income and comprehensive income attributable to Expedia, Inc. was foreign currency translation adjustments.

**Note 6 Earnings Per Share**

The following table presents our basic and diluted earnings per share:

|                                                                                    | Three months ended June 30,           |           | Six months ended June 30, |           |
|------------------------------------------------------------------------------------|---------------------------------------|-----------|---------------------------|-----------|
|                                                                                    | 2010                                  | 2009      | 2010                      | 2009      |
|                                                                                    | (In thousands, except per share data) |           |                           |           |
| Net income attributable to Expedia, Inc.                                           | \$ 114,262                            | \$ 40,902 | \$ 173,657                | \$ 80,286 |
| Earnings per share attributable to Expedia, Inc. available to common stockholders: |                                       |           |                           |           |
| Basic                                                                              | \$ 0.40                               | \$ 0.14   | \$ 0.61                   | \$ 0.28   |
| Diluted                                                                            | 0.40                                  | 0.14      | 0.60                      | 0.28      |
| Weighted average number of shares outstanding:                                     |                                       |           |                           |           |
| Basic                                                                              | 284,088                               | 288,180   | 286,333                   | 287,764   |
| Dilutive effect of:                                                                |                                       |           |                           |           |
| Options to purchase common stock                                                   | 4,027                                 | 2,067     | 4,256                     | 1,090     |
| Other dilutive securities                                                          | 860                                   | 642       | 1,137                     | 530       |
| Diluted                                                                            | 288,975                               | 290,889   | 291,726                   | 289,384   |

The earnings per share amounts are the same for common stock and Class B common stock because the holders of each class are legally entitled to equal per share distributions whether through dividends or in liquidation.

**Note 7 Restructuring Charges**

During the six months ended June 30, 2009, in conjunction with the reorganization of our business around our global brands, we recognized \$15 million in restructuring charges. Restructuring charges related to our brand reorganization were substantially completed by the end of 2009 for a total expense of \$34 million, the majority of which will be paid by the end of 2010. There were no restructuring charges recognized for the six months ended June 30, 2010.

**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

The following table summarizes the restructuring liability activity for the six months ended June 30, 2010:

|                                         | <b>Employee<br/>Severance and<br/>Benefits</b> | <b>Other<br/>(In thousands)</b> | <b>Total</b> |
|-----------------------------------------|------------------------------------------------|---------------------------------|--------------|
| Accrued liability as of January 1, 2010 | \$ 19,056                                      | \$ 1,318                        | \$ 20,374    |
| Payments                                | (12,559)                                       | (653)                           | (13,212)     |
| Accrued liability as of June 30, 2010   | \$ 6,497                                       | \$ 665                          | \$ 7,162     |

**Note 8 Income Taxes**

We determine our provision for income taxes for interim periods using an estimate of our annual effective rate. We record any changes to the estimated annual rate in the interim period in which the change occurs, including discrete tax items. The 2010 effective rate is estimated to be lower than the 35% federal statutory rate primarily due to an increase in estimated earnings in jurisdictions outside of the United States, where our effective tax rate is lower than in the United States.

The IRS is in the process of concluding its audit of our consolidated federal tax return for the periods ended December 31, 2005 through December 31, 2007. It is reasonably possible that the conclusion of the audit could result in a decrease to our liability for uncertain tax positions of up to \$132 million, of which up to \$17 million, if recognized, would decrease our provision for income taxes.

**Note 9 Commitments and Contingencies*****Legal Proceedings***

In the ordinary course of business, we are a party to various lawsuits. Management does not expect these lawsuits to have a material impact on the liquidity, results of operations, or financial condition of Expedia. We also evaluate other potential contingent matters, including value-added tax, federal excise tax, transient occupancy or accommodation tax and similar matters.

*Litigation Relating to Hotel Occupancy Taxes.* Fifty-nine lawsuits have been filed by cities and counties involving hotel occupancy taxes. In addition, there are three pending consumer lawsuits relating to taxes or fees. The municipality and consumer lawsuits are in various stages. We continue to defend these lawsuits vigorously. With respect to the principal claims in these matters, we believe that the ordinances at issue do not apply to the services we provide, namely the facilitation of hotel reservations, and, therefore, that we do not owe the taxes that are claimed to be owed. We believe that the ordinances at issue generally impose occupancy and other taxes on entities that own, operate or control hotels (or similar businesses) or furnish or provide hotel rooms or similar accommodations. To date, twenty of the municipality lawsuits have been dismissed. Most of these dismissals have been without prejudice and, generally, allow the municipality to seek administrative remedies prior to pursuing further litigation. Eight dismissals (Pitt County, North Carolina; City of Madison, Wisconsin; City of Orange, Texas; Fayetteville, Arkansas; Houston, Texas; Louisville, Kentucky; Township of Lyndhurst, New Jersey and Bowling Green, Kentucky) were based on a finding that we and the other defendants were not subject to the local hotel occupancy tax ordinance or that the local government lacked standing to pursue their claims. As a result of this litigation and other attempts by certain jurisdictions to levy such taxes, we have established a reserve for the potential settlement of issues related to hotel occupancy taxes in the amount of \$27 million as of June 30, 2010 and \$21 million as of December 31, 2009. Our reserve is based on our best estimate and the ultimate resolution of these contingencies may be greater or less than the liabilities recorded.

In connection with various occupancy tax audits and assessments, certain jurisdictions may assert that taxpayers are required to pay any assessed taxes prior to being allowed to contest or litigate the applicability of the ordinances, which is referred to as pay-to-play. These jurisdictions may attempt to require that we pay any assessed taxes prior to being allowed to contest or litigate the applicability of the tax ordinance. Payment of these amounts is not an admission that we believe we are subject to such taxes and, even when such payments are made, we continue to defend our position.



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### **Notes to Consolidated Financial Statements (Continued)**

vigorously. During 2009, we expensed and paid approximately \$48 million (\$55 million was expensed in the second quarter of 2009 and subsequently adjusted) to the City of San Francisco for amounts assessed for hotel occupancy tax, including penalties and interest, from January 2000 to March 2009. We paid such amounts in order to be allowed to pursue litigation challenging whether we are required to pay hotel occupancy tax on the portion of the customer payment we retain as compensation and, if so, the actual amounts owed. We do not believe that the amounts we retain as compensation are subject to the city's hotel occupancy tax ordinance. If we prevail in the litigation, the city will be required to repay these amounts, plus interest. During the first quarter of 2009, the California Superior Court for Orange County determined we are not required to make a payment in order to litigate in Anaheim, California. That decision was affirmed by the California Court of Appeals on March 24, 2010 and the California Supreme Court denied the city's petition for review.

*Expedia.com Consumer Class Action Lawsuit.* The third-party appeals of the court's order approving the settlement agreement related to the Expedia.com Consumer Class Action lawsuit were dismissed on April 14, 2010. We paid \$12 million of the settlement amount during the second quarter of 2010. The remaining settlement liability includes an estimated coupon redemption rate. Any difference between our estimated redemption rate and the actual redemption rate we experience will impact the final settlement amount; however, we do not expect this difference to be material.

#### **Note 10 Segment Information**

We have three reportable segments: Leisure, TripAdvisor Media Network and Egencia. We determined our segments based on how our chief operating decision makers manage our business, make operating decisions and evaluate operating performance. Our primary operating metric for evaluating segment performance is Operating Income Before Amortization (OIBA). OIBA for our Leisure and Egencia segments includes allocations of certain expenses, primarily cost of revenue and facilities, and our Leisure segment includes the total costs of our Partner Services Group as well as the realized foreign currency gains or losses related to the forward contracts hedging a component of our net merchant hotel revenue. We base the allocations primarily on transaction volumes and other usage metrics; this methodology is periodically evaluated and may change. We do not allocate certain shared expenses such as accounting, human resources, information technology and legal to our reportable segments. We include these expenses in Corporate and Eliminations.

Our Leisure segment provides a full range of travel and advertising services to our worldwide customers through a variety of brands including: Expedia.com and Hotels.com in the United States and localized Expedia and Hotels.com websites throughout the world, Expedia Affiliate Network, Hotwire.com, Venere, eLong and Classic Vacations. Our TripAdvisor Media Network segment provides advertising services to travel suppliers on its websites, which aggregate traveler opinions and unbiased travel articles about cities, hotels, restaurants and activities in a variety of destinations through tripadvisor.com and its localized international versions as well as through its various travel media content properties within TripAdvisor Media Network. Our Egencia segment provides managed travel services to corporate customers in North America, Europe, and the Asia Pacific region.

Our segment disclosure includes intersegment revenues, which primarily consist of advertising and media services provided by our TripAdvisor Media Network segment to our Leisure segment. These intersegment transactions are recorded by each segment at estimated fair value as if the transactions were with third parties and, therefore, impact segment performance. However, the revenue and corresponding expense are eliminated in consolidation. The elimination of such intersegment transactions is included within Corporate and Eliminations in the table below.

Corporate and Eliminations also includes unallocated corporate functions and expenses. In addition, we record amortization of intangible assets and any related impairment, as well as stock-based compensation expense and restructuring charges in Corporate and Eliminations.

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### Notes to Consolidated Financial Statements (Continued)

The following tables present our segment information for the three and six months ended June 30, 2010 and 2009. As a significant portion of our property and equipment is not allocated to our operating segments, we do not report the assets or related depreciation expense as it would not be meaningful, nor do we regularly provide such information to our chief operating decision makers.

|                                                     | Three months ended June 30, 2010 |                              |                           |                             | Total             |
|-----------------------------------------------------|----------------------------------|------------------------------|---------------------------|-----------------------------|-------------------|
|                                                     | Leisure                          | TripAdvisor<br>Media Network | Egencia<br>(In thousands) | Corporate &<br>Eliminations |                   |
| Third-party Revenue                                 | \$ 715,998                       | \$ 82,423                    | \$ 35,539                 | \$                          | \$ 833,960        |
| Intersegment Revenue                                |                                  | 42,987                       |                           | (42,987)                    |                   |
| Revenue                                             | \$ 715,998                       | \$ 125,410                   | \$ 35,539                 | \$ (42,987)                 | \$ 833,960        |
| Operating Income Before Amortization                | \$ 213,959                       | \$ 72,854                    | \$ 5,237                  | \$ (72,578)                 | \$ 219,472        |
| Amortization of intangible assets                   |                                  |                              |                           | (8,344)                     | (8,344)           |
| Stock-based compensation                            |                                  |                              |                           | (14,651)                    | (14,651)          |
| Realized (gain)/loss on revenue hedges              | (2,787)                          |                              |                           |                             | (2,787)           |
| Operating income                                    | \$ 211,172                       | \$ 72,854                    | \$ 5,237                  | \$ (95,573)                 | 193,690           |
| Other expense, net                                  |                                  |                              |                           |                             | (18,171)          |
| Income before income taxes                          |                                  |                              |                           |                             | 175,519           |
| Provision for income taxes                          |                                  |                              |                           |                             | (60,166)          |
| Net income                                          |                                  |                              |                           |                             | 115,353           |
| Net income attributable to noncontrolling interests |                                  |                              |                           |                             | (1,091)           |
| <b>Net income attributable to Expedia, Inc.</b>     |                                  |                              |                           |                             | <b>\$ 114,262</b> |

|                                              | Three months ended June 30, 2009 |                              |                           |                             | Total      |
|----------------------------------------------|----------------------------------|------------------------------|---------------------------|-----------------------------|------------|
|                                              | Leisure                          | TripAdvisor<br>Media Network | Egencia<br>(In thousands) | Corporate &<br>Eliminations |            |
| Third-party Revenue                          | \$ 689,975                       | \$ 53,159                    | \$ 26,634                 | \$                          | \$ 769,768 |
| Intersegment Revenue                         |                                  | 36,916                       |                           | (36,916)                    |            |
| Revenue                                      | \$ 689,975                       | \$ 90,075                    | \$ 26,634                 | \$ (36,916)                 | \$ 769,768 |
| Operating Income Before Amortization         | \$ 227,786                       | \$ 52,010                    | \$ (128)                  | \$ (67,252)                 | \$ 212,416 |
| Amortization of intangible assets            |                                  |                              |                           | (9,302)                     | (9,302)    |
| Stock-based compensation                     |                                  |                              |                           | (13,576)                    | (13,576)   |
| Occupancy tax assessments and legal reserves |                                  |                              |                           | (74,211)                    | (74,211)   |
| Restructuring charges                        |                                  |                              |                           | (6,098)                     | (6,098)    |
| Realized (gain)/loss on revenue hedges       | 5,413                            |                              |                           |                             | 5,413      |
| Operating income (loss)                      | \$ 233,199                       | \$ 52,010                    | \$ (128)                  | \$ (170,439)                | 114,642    |

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|                                                     |                  |
|-----------------------------------------------------|------------------|
| Other expense, net                                  | (38,461)         |
| Income before income taxes                          | 76,181           |
| Provision for income taxes                          | (34,338)         |
| Net income                                          | 41,843           |
| Net income attributable to noncontrolling interests | (941)            |
| <b>Net income attributable to Expedia, Inc.</b>     | <b>\$ 40,902</b> |

**Table of Contents****Notes to Consolidated Financial Statements (Continued)**

|                                                     | Six months ended June 30, 2010 |                              |                           |                             |                   |
|-----------------------------------------------------|--------------------------------|------------------------------|---------------------------|-----------------------------|-------------------|
|                                                     | Leisure                        | TripAdvisor<br>Media Network | Egencia<br>(In thousands) | Corporate &<br>Eliminations | Total             |
| Third-party Revenue                                 | \$ 1,328,628                   | \$ 153,924                   | \$ 69,327                 | \$                          | \$ 1,551,879      |
| Intersegment Revenue                                |                                | 85,068                       |                           | (85,068)                    |                   |
| Revenue                                             | \$ 1,328,628                   | \$ 238,992                   | \$ 69,327                 | \$ (85,068)                 | \$ 1,551,879      |
| Operating Income Before Amortization                | \$ 351,341                     | \$ 139,315                   | \$ 10,952                 | \$ (139,592)                | \$ 362,016        |
| Amortization of intangible assets                   |                                |                              |                           | (17,372)                    | (17,372)          |
| Stock-based compensation                            |                                |                              |                           | (33,543)                    | (33,543)          |
| Realized (gain)/loss on revenue hedges              | (5,237)                        |                              |                           |                             | (5,237)           |
| Operating income                                    | \$ 346,104                     | \$ 139,315                   | \$ 10,952                 | \$ (190,507)                | 305,864           |
| Other expense, net                                  |                                |                              |                           |                             | (38,211)          |
| Income before income taxes                          |                                |                              |                           |                             | 267,653           |
| Provision for income taxes                          |                                |                              |                           |                             | (91,701)          |
| Net income                                          |                                |                              |                           |                             | 175,952           |
| Net income attributable to noncontrolling interests |                                |                              |                           |                             | (2,295)           |
| <b>Net income attributable to Expedia, Inc.</b>     |                                |                              |                           |                             | <b>\$ 173,657</b> |

|                                                     | Six months ended June 30, 2009 |                              |                           |                             |              |
|-----------------------------------------------------|--------------------------------|------------------------------|---------------------------|-----------------------------|--------------|
|                                                     | Leisure                        | TripAdvisor<br>Media Network | Egencia<br>(In thousands) | Corporate &<br>Eliminations | Total        |
| Third-party Revenue                                 | \$ 1,249,175                   | \$ 104,632                   | \$ 51,673                 | \$                          | \$ 1,405,480 |
| Intersegment Revenue                                |                                | 70,945                       |                           | (70,945)                    |              |
| Revenue                                             | \$ 1,249,175                   | \$ 175,577                   | \$ 51,673                 | \$ (70,945)                 | \$ 1,405,480 |
| Operating Income Before Amortization                | \$ 378,668                     | \$ 100,091                   | \$ (1,348)                | \$ (135,208)                | \$ 342,203   |
| Amortization of intangible assets                   |                                |                              |                           | (18,371)                    | (18,371)     |
| Stock-based compensation                            |                                |                              |                           | (32,148)                    | (32,148)     |
| Occupancy tax assessments and legal reserves        |                                |                              |                           | (74,211)                    | (74,211)     |
| Restructuring charges                               |                                |                              |                           | (14,816)                    | (14,816)     |
| Realized (gain)/loss on revenue hedges              | 4,932                          |                              |                           |                             | 4,932        |
| Operating income (loss)                             | \$ 383,600                     | \$ 100,091                   | \$ (1,348)                | \$ (274,754)                | 207,589      |
| Other expense, net                                  |                                |                              |                           |                             | (64,382)     |
| Income before income taxes                          |                                |                              |                           |                             | 143,207      |
| Provision for income taxes                          |                                |                              |                           |                             | (61,610)     |
| Net income                                          |                                |                              |                           |                             | 81,597       |
| Net income attributable to noncontrolling interests |                                |                              |                           |                             | (1,311)      |

**Net income attributable to Expedia, Inc.**

\$ 80,286

We revised prior year OIBA by segment to conform to our current year presentation. There was no impact on consolidated OIBA as a result of these changes.



**Table of Contents****Notes to Consolidated Financial Statements (Continued)****NOTE 11 Guarantor and Non-Guarantor Supplemental Financial Information**

Condensed consolidating financial information of Expedia, Inc. (the Parent), our subsidiaries that are guarantors of our debt facility and instruments (the Guarantor Subsidiaries), and our subsidiaries that are not guarantors of our debt facility and instruments (the Non-Guarantor Subsidiaries) is shown below. The debt facility and instruments are guaranteed by certain of our wholly-owned domestic subsidiaries and rank equally in right of payment with all of our existing and future unsecured and unsubordinated obligations. The guarantees are full, unconditional, joint and several. In this financial information, the Parent and Guarantor Subsidiaries account for investments in their wholly-owned subsidiaries using the equity method.

**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****Three Months Ended June 30, 2010**

(in thousands)

|                                                         | <b>Parent</b>     | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---------------------------------------------------------|-------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| Revenue                                                 | \$                | \$ 701,400                        | \$ 227,015                            | \$ (94,455)         | \$ 833,960          |
| Costs and expenses:                                     |                   |                                   |                                       |                     |                     |
| Cost of revenue                                         |                   | 150,786                           | 18,961                                | (1,176)             | 168,571             |
| Selling and marketing                                   |                   | 285,957                           | 104,138                               | (93,265)            | 296,830             |
| Technology and content                                  |                   | 70,130                            | 17,290                                |                     | 87,420              |
| General and administrative                              |                   | 35,839                            | 43,280                                | (14)                | 79,105              |
| Amortization of intangible assets                       |                   | 2,951                             | 5,393                                 |                     | 8,344               |
| Operating income                                        |                   | 155,737                           | 37,953                                |                     | 193,690             |
| Other income (expense):                                 |                   |                                   |                                       |                     |                     |
| Equity in pre-tax earnings of consolidated subsidiaries | 125,239           | 11,339                            |                                       | (136,578)           |                     |
| Other, net                                              | (18,157)          | 32,840                            | (32,854)                              |                     | (18,171)            |
| Total other income (expense), net                       | 107,082           | 44,179                            | (32,854)                              | (136,578)           | (18,171)            |
| Income before income taxes                              | 107,082           | 199,916                           | 5,099                                 | (136,578)           | 175,519             |
| Provision for income taxes                              | 7,180             | (73,849)                          | 6,503                                 |                     | (60,166)            |
| Net income                                              | 114,262           | 126,067                           | 11,602                                | (136,578)           | 115,353             |
| Net income attributable to noncontrolling interest      |                   |                                   | (1,091)                               |                     | (1,091)             |
| <b>Net income attributable to Expedia, Inc.</b>         | <b>\$ 114,262</b> | <b>\$ 126,067</b>                 | <b>\$ 10,511</b>                      | <b>\$ (136,578)</b> | <b>\$ 114,262</b>   |

**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****Three Months Ended June 30, 2009**

(In thousands)

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|                                                         | Parent           | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations       | Consolidated     |
|---------------------------------------------------------|------------------|---------------------------|-------------------------------|--------------------|------------------|
| Revenue                                                 | \$               | \$ 660,787                | \$ 205,433                    | \$ (96,452)        | \$ 769,768       |
| Costs and expenses:                                     |                  |                           |                               |                    |                  |
| Cost of revenue                                         |                  | 119,740                   | 30,284                        | (1,262)            | 148,762          |
| Selling and marketing                                   |                  | 257,164                   | 109,517                       | (95,189)           | 271,492          |
| Technology and content                                  |                  | 62,411                    | 15,464                        | 6                  | 77,881           |
| General and administrative                              |                  | 44,789                    | 22,598                        | (7)                | 67,380           |
| Amortization of intangible assets                       |                  | 2,841                     | 6,461                         |                    | 9,302            |
| Occupancy tax assessments and legal reserves            |                  | 74,211                    |                               |                    | 74,211           |
| Restructuring charges                                   |                  | 3,771                     | 2,327                         |                    | 6,098            |
| Operating income                                        |                  | 95,860                    | 18,782                        |                    | 114,642          |
| Other income (expense):                                 |                  |                           |                               |                    |                  |
| Equity in pre-tax earnings of consolidated subsidiaries | 52,566           | 1,269                     |                               | (53,835)           |                  |
| Other, net                                              | (18,188)         | (13,966)                  | (6,307)                       |                    | (38,461)         |
| Total other income (expense), net                       | 34,378           | (12,697)                  | (6,307)                       | (53,835)           | (38,461)         |
| Income before income taxes                              | 34,378           | 83,163                    | 12,475                        | (53,835)           | 76,181           |
| Provision for income taxes                              | 6,524            | (29,247)                  | (11,615)                      |                    | (34,338)         |
| Net income                                              | 40,902           | 53,916                    | 860                           | (53,835)           | 41,843           |
| Net income attributable to noncontrolling interest      |                  |                           | (941)                         |                    | (941)            |
| <b>Net income (loss) attributable to Expedia, Inc.</b>  | <b>\$ 40,902</b> | <b>\$ 53,916</b>          | <b>\$ (81)</b>                | <b>\$ (53,835)</b> | <b>\$ 40,902</b> |

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### Notes to Consolidated Financial Statements (Continued)

#### CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

Six Months Ended June 30, 2010

(in thousands)

|                                                         | Parent            | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations        | Consolidated      |
|---------------------------------------------------------|-------------------|---------------------------|-------------------------------|---------------------|-------------------|
| Revenue                                                 | \$                | \$ 1,299,449              | \$ 442,526                    | \$ (190,096)        | \$ 1,551,879      |
| Costs and expenses:                                     |                   |                           |                               |                     |                   |
| Cost of revenue                                         |                   | 282,949                   | 44,948                        | (1,296)             | 326,601           |
| Selling and marketing                                   |                   | 569,095                   | 197,378                       | (188,805)           | 577,668           |
| Technology and content                                  |                   | 139,280                   | 34,918                        | 13                  | 174,211           |
| General and administrative                              |                   | 73,459                    | 76,712                        | (8)                 | 150,163           |
| Amortization of intangible assets                       |                   | 6,414                     | 10,958                        |                     | 17,372            |
| Operating income                                        |                   | 228,252                   | 77,612                        |                     | 305,864           |
| Other income (expense):                                 |                   |                           |                               |                     |                   |
| Equity in pre-tax earnings of consolidated subsidiaries | 195,910           | 24,828                    |                               | (220,738)           |                   |
| Other, net                                              | (36,337)          | 55,187                    | (57,061)                      |                     | (38,211)          |
| Total other income (expense), net                       | 159,573           | 80,015                    | (57,061)                      | (220,738)           | (38,211)          |
| Income before income taxes                              | 159,573           | 308,267                   | 20,551                        | (220,738)           | 267,653           |
| Provision for income taxes                              | 14,084            | (109,876)                 | 4,091                         |                     | (91,701)          |
| Net income                                              | 173,657           | 198,391                   | 24,642                        | (220,738)           | 175,952           |
| Net income attributable to noncontrolling interest      |                   |                           | (2,295)                       |                     | (2,295)           |
| <b>Net income attributable to Expedia, Inc.</b>         | <b>\$ 173,657</b> | <b>\$ 198,391</b>         | <b>\$ 22,347</b>              | <b>\$ (220,738)</b> | <b>\$ 173,657</b> |

#### CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

Six Months Ended June 30, 2009

(In thousands)

|                            | Parent | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|----------------------------|--------|---------------------------|-------------------------------|--------------|--------------|
| Revenue                    | \$     | \$ 1,210,843              | \$ 369,746                    | \$ (175,109) | \$ 1,405,480 |
| Costs and expenses:        |        |                           |                               |              |              |
| Cost of revenue            |        | 237,533                   | 57,146                        | (2,404)      | 292,275      |
| Selling and marketing      |        | 473,772                   | 206,278                       | (172,674)    | 507,376      |
| Technology and content     |        | 125,042                   | 30,502                        | 9            | 155,553      |
| General and administrative |        | 90,916                    | 44,413                        | (40)         | 135,289      |

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|                                                                  |                  |                   |                   |                     |                  |
|------------------------------------------------------------------|------------------|-------------------|-------------------|---------------------|------------------|
| Amortization of intangible assets                                |                  | 5,680             | 12,691            |                     | 18,371           |
| Occupancy tax assessments and legal reserves                     |                  | 74,211            |                   |                     | 74,211           |
| Restructuring charges                                            |                  | 10,775            | 4,041             |                     | 14,816           |
| Operating income                                                 |                  | 192,914           | 14,675            |                     | 207,589          |
| Other income (expense):                                          |                  |                   |                   |                     |                  |
| Equity in pre-tax earnings (losses) of consolidated subsidiaries | 103,376          | (1,551)           |                   | (101,825)           |                  |
| Other, net                                                       | (36,363)         | (20,777)          | (7,242)           |                     | (64,382)         |
| Total other income (expense), net                                | 67,013           | (22,328)          | (7,242)           | (101,825)           | (64,382)         |
| Income before income taxes                                       | 67,013           | 170,586           | 7,433             | (101,825)           | 143,207          |
| Provision for income taxes                                       | 13,273           | (64,901)          | (9,982)           |                     | (61,610)         |
| Net income (loss)                                                | 80,286           | 105,685           | (2,549)           | (101,825)           | 81,597           |
| Net income attributable to noncontrolling interest               |                  |                   | (1,311)           |                     | (1,311)          |
| <b>Net income (loss) attributable to Expedia, Inc.</b>           | <b>\$ 80,286</b> | <b>\$ 105,685</b> | <b>\$ (3,860)</b> | <b>\$ (101,825)</b> | <b>\$ 80,286</b> |

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## Notes to Consolidated Financial Statements (Continued)

### CONDENSED CONSOLIDATING BALANCE SHEET

June 30, 2010

(in thousands)

|                                                  | Parent              | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations          | Consolidated        |
|--------------------------------------------------|---------------------|---------------------------|-------------------------------|-----------------------|---------------------|
| <b>ASSETS</b>                                    |                     |                           |                               |                       |                     |
| Total current assets                             | \$ 80,676           | \$ 2,484,526              | \$ 429,435                    | \$ (1,178,946)        | \$ 1,815,691        |
| Investment in subsidiaries                       | 4,276,263           | 505,534                   |                               | (4,781,797)           |                     |
| Intangible assets, net                           |                     | 678,228                   | 123,100                       |                       | 801,328             |
| Goodwill                                         |                     | 3,057,801                 | 538,963                       |                       | 3,596,764           |
| Other assets, net                                | 2,670               | 323,428                   | 83,013                        |                       | 409,111             |
| <b>TOTAL ASSETS</b>                              | <b>\$ 4,359,609</b> | <b>\$ 7,049,517</b>       | <b>\$ 1,174,511</b>           | <b>\$ (5,960,743)</b> | <b>\$ 6,622,894</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>       |                     |                           |                               |                       |                     |
| Total current liabilities                        | \$ 797,681          | \$ 2,368,382              | \$ 600,105                    | \$ (1,178,946)        | \$ 2,587,222        |
| Long-term debt                                   | 895,374             |                           |                               |                       | 895,374             |
| Other liabilities                                |                     | 389,801                   | 83,943                        |                       | 473,744             |
| Stockholders' equity                             | 2,666,554           | 4,291,334                 | 490,463                       | (4,781,797)           | 2,666,554           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b> | <b>\$ 4,359,609</b> | <b>\$ 7,049,517</b>       | <b>\$ 1,174,511</b>           | <b>\$ (5,960,743)</b> | <b>\$ 6,622,894</b> |

### CONDENSED CONSOLIDATING BALANCE SHEET

December 31, 2009

(In thousands)

|                                            | Parent              | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations          | Consolidated        |
|--------------------------------------------|---------------------|---------------------------|-------------------------------|-----------------------|---------------------|
| <b>ASSETS</b>                              |                     |                           |                               |                       |                     |
| Total current assets                       | \$ 95,846           | \$ 1,643,085              | \$ 420,379                    | \$ (934,261)          | \$ 1,225,049        |
| Investment in subsidiaries                 | 4,163,845           | 590,536                   |                               | (4,754,381)           |                     |
| Intangible assets, net                     |                     | 684,367                   | 138,664                       |                       | 823,031             |
| Goodwill                                   |                     | 3,057,942                 | 546,052                       |                       | 3,603,994           |
| Other assets, net                          | 3,128               | 199,838                   | 82,116                        |                       | 285,082             |
| <b>TOTAL ASSETS</b>                        | <b>\$ 4,262,819</b> | <b>\$ 6,175,768</b>       | <b>\$ 1,187,211</b>           | <b>\$ (5,688,642)</b> | <b>\$ 5,937,156</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b> |                     |                           |                               |                       |                     |
| Total current liabilities                  | \$ 618,007          | \$ 1,621,449              | \$ 529,862                    | \$ (934,261)          | \$ 1,835,057        |
| Long-term debt                             | 895,086             |                           |                               |                       | 895,086             |
| Other liabilities                          |                     | 377,821                   | 79,466                        |                       | 457,287             |
| Stockholders' equity                       | 2,749,726           | 4,176,498                 | 577,883                       | (4,754,381)           | 2,749,726           |

|                                                  |              |              |              |                |              |
|--------------------------------------------------|--------------|--------------|--------------|----------------|--------------|
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b> | \$ 4,262,819 | \$ 6,175,768 | \$ 1,187,211 | \$ (5,688,642) | \$ 5,937,156 |
|--------------------------------------------------|--------------|--------------|--------------|----------------|--------------|

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## Notes to Consolidated Financial Statements (Continued)

**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**
**Six Months Ended June 30, 2010**

(in thousands)

|                                                              | Parent    | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidated |
|--------------------------------------------------------------|-----------|---------------------------|-------------------------------|--------------|
| <b>Operating activities:</b>                                 |           |                           |                               |              |
| Net cash provided by operating activities                    | \$        | \$ 824,676                | \$ 108,657                    | \$ 933,333   |
| <b>Investing activities:</b>                                 |           |                           |                               |              |
| Purchases of investments                                     |           | (395,756)                 | (33,727)                      | (429,483)    |
| Maturities of investments                                    |           |                           | 46,912                        | 46,912       |
| Other, net                                                   |           | (61,621)                  | (47,146)                      | (108,767)    |
| Net cash provided by (used in) investing activities          |           | (457,377)                 | (33,961)                      | (491,338)    |
| <b>Financing activities:</b>                                 |           |                           |                               |              |
| Payment of dividends to stockholders                         | (40,122)  |                           |                               | (40,122)     |
| Treasury stock activity                                      | (198,504) |                           |                               | (198,504)    |
| Transfers (to) from related parties                          | 203,874   | (203,874)                 |                               |              |
| Other, net                                                   | 34,752    | (10,299)                  | (26,607)                      | (2,154)      |
| Net cash used in financing activities                        |           | (214,173)                 | (26,607)                      | (240,780)    |
| Effect of exchange rate changes on cash and cash equivalents |           | (10,119)                  | (37,786)                      | (47,905)     |
| <b>Net increase in cash and cash equivalents</b>             |           | 143,007                   | 10,303                        | 153,310      |
| Cash and cash equivalents at beginning of period             |           | 418,855                   | 223,689                       | 642,544      |
| <b>Cash and cash equivalents at end of period</b>            | \$        | \$ 561,862                | \$ 233,992                    | \$ 795,854   |

**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**
**Six Months Ended June 30, 2009**

(In thousands)

|                                           | Parent | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidated |
|-------------------------------------------|--------|---------------------------|-------------------------------|--------------|
| <b>Operating activities:</b>              |        |                           |                               |              |
| Net cash provided by operating activities | \$     | \$ 824,351                | \$ 20,199                     | \$ 844,550   |
| <b>Investing activities:</b>              |        |                           |                               |              |
| Net cash provided by investing activities |        | 11,270                    | 23,968                        | 35,238       |

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|                                                              |           |                   |                   |                   |
|--------------------------------------------------------------|-----------|-------------------|-------------------|-------------------|
| <b>Financing activities:</b>                                 |           |                   |                   |                   |
| Credit facility repayments                                   |           | (650,000)         |                   | (650,000)         |
| Transfers (to) from related parties                          | 4,895     | (12,866)          | 7,971             |                   |
| Other, net                                                   | (4,895)   | (14,009)          | (9,070)           | (27,974)          |
| Net cash used in financing activities                        |           | (676,875)         | (1,099)           | (677,974)         |
| Effect of exchange rate changes on cash and cash equivalents |           | (8,587)           | 3,655             | (4,932)           |
| <b>Net increase in cash and cash equivalents</b>             |           | <b>150,159</b>    | <b>46,723</b>     | <b>196,882</b>    |
| Cash and cash equivalents at beginning of period             |           | 538,341           | 127,071           | 665,412           |
| <b>Cash and cash equivalents at end of period</b>            | <b>\$</b> | <b>\$ 688,500</b> | <b>\$ 173,794</b> | <b>\$ 862,294</b> |



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### **Part I. Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### ***Forward-Looking Statements***

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect the views of our management regarding current expectations and projections about future events and are based on currently available information. Actual results could differ materially from those contained in these forward-looking statements for a variety of reasons, including, but not limited to, those discussed in our Annual Report on Form 10-K for the year ended December 31, 2009, Part I, Item 1A, Risk Factors, as well as those discussed elsewhere in this report. Other unknown or unpredictable factors also could have a material adverse effect on our business, financial condition and results of operations. Accordingly, readers should not place undue reliance on these forward-looking statements. The use of words such as anticipates, estimates, expects, intends, plans and believes, among others, generally identify forward-looking statements; however, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. These forward-looking statements are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. We are not under any obligation to, and do not intend to, publicly update or review any of these forward-looking statements, whether as a result of new information, future events or otherwise, even if experience or future events make it clear that any expected results expressed or implied by those forward-looking statements will not be realized. Please carefully review and consider the various disclosures made in this report and in our other reports filed with the Securities and Exchange Commission (SEC) that attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

The information included in this management's discussion and analysis of financial condition and results of operations should be read in conjunction with our consolidated financial statements and the notes included in this Quarterly Report, and the audited consolidated financial statements and notes and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2009.

#### ***Overview***

Expedia, Inc. is an online travel company, empowering business and leisure travelers with the tools and information they need to efficiently research, plan, book and experience travel. We have created a global travel marketplace used by a broad range of leisure and corporate travelers, offline retail travel agents and travel service providers. We make available, on a stand-alone and package basis, travel products and services provided by numerous airlines, lodging properties, car rental companies, destination service providers, cruise lines and other travel product and service companies. We also offer travel and non-travel advertisers access to a potential source of incremental traffic and transactions through our various media and advertising offerings on both TripAdvisor® Media Network and on our transaction-based websites.

Our portfolio of brands includes Expedia.com®, Hotels.com®, Hotwire.com, TripAdvisor Media Network, Expedia Affiliate Network, Classic Vacations, Expedia Local Expert, Expedia® CruiseShipCenters®, Egencia, eLong, and Venere Net SpA (Venere). In addition, many of these brands have related international points of sale. For additional information about our portfolio of brands, see Portfolio of Brands in Part I, Item 1, Business, in our Annual Report on Form 10-K for the year ended December 31, 2009.

All percentages within this section are calculated on actual, unrounded numbers.

#### ***Trends***

The travel industry, including offline agencies, online agencies and other suppliers of travel products and services, has historically been characterized by intense competition, as well as rapid and significant change. In addition, beginning in September 2008, global economic and financial market conditions worsened markedly, creating uncertainty for travelers and suppliers. This macroeconomic downturn pressured discretionary spending on travel and advertising, with initial weakness in the United States and the United Kingdom markets increasing and spreading to all geographies. Although current macroeconomic trends have been generally stable to slightly improved, unemployment remains at historically high levels and

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consumer spending remains pressured. More recently, volcanic activity and related travel disruptions, foreign currency fluctuations (primarily the devaluation of the Euro), overall uncertainty about the European economy and rising airfares have all contributed to pressure on the travel industry generally and our volumes specifically. Our near-term visibility remains limited.

### *Airline Sector*

The airline sector in particular has historically experienced significant turmoil. U.S. airlines responded to chronic overcapacity, financial losses and extreme volatility in oil prices by aggressively reducing their cost structures and seating capacities. Reduced seating capacities are generally negative for Expedia as there is less air supply available on our websites, and in turn less opportunity to facilitate hotel rooms, car rental and other services on behalf of air travelers. Most carriers aggressively reduced capacities in 2008 and 2009, and at this time, plans for re-visiting capacity expansion in 2010 appear to be relatively limited. Recently there has been increased carrier consolidation, which tends to put additional pressure on capacity and fares.

In 2008, many carriers raised their per seat yields by increasing fares, assessing fuel surcharges and increasing the use of a la carte pricing for such items as baggage, food and beverage and preferred seating. Since then, the use of ancillary fees to supplement revenues has remained, and in some cases been expanded. However, as overall travel demand waned at the end of 2008 and into 2009, carriers began lowering ticket prices in order to attract more leisure travelers.

Expedia generally benefits from a low fare environment, as low fares tend to encourage leisure travel, leave more of the travel budget available for hotel spend and because our air revenues are tied principally to ticket volumes, not prices. Hence, the 2009 fare environment was a favorable one for Expedia, as airfares on tickets sold by Expedia decreased 15% in 2009, contributing to 15% growth in air tickets sold. More recently, however, given the stabilization in the macro economy and aggressive capacity reductions, carriers have begun increasing fares. In the second quarter of 2010, airfares on Expedia sites were up 17%, and our current forecasts indicate that airfare increases will likely continue at least through the summer travel season.

In the spring of 2009, Expedia.com and other major online travel agencies began offering air tickets to consumers without an associated online booking fee, matching the airline supplier sites, which also do not charge online booking fees. Expedia broadened this fee elimination to many of its international websites, as well as removed most change/cancel fees in excess of those charged by travel suppliers. These fee actions, combined with the above reductions in distribution costs, have combined to reduce Expedia's global revenue per ticket by over 30% in the past three years. We passed the anniversary of these fee cuts beginning in March 2010 which eliminated the pressure on revenue per ticket but contributed to a meaningful decline in our rate of growth in air tickets sold.

As a result of the above industry dynamics and the strength of our other product lines, in 2009 air revenue constituted just 12% of our global revenues. We may encounter additional pressure on air remuneration as certain supply agreements renew in 2010 and beyond, and as air carriers and GDSs re-negotiate their long-term agreements in 2011.

In addition to the above challenges, larger carriers participating in the Expedia marketplace have generally reduced their share of total air seat capacity, while leading low-cost carriers such as Southwest in the United States have increased their relative capacities, but have generally chosen not to participate in the Expedia marketplace. This trend has negatively impacted our ability to obtain supply in our air business, and increased the relative attractiveness of other online and offline sales channels.

### *Hotel Sector*

In 2008, the hotel sector witnessed supply growth and slowing demand, resulting in declining occupancy rates. Average Daily Rate (ADR) growth, which had been robust in 2006 and 2007, slowed considerably throughout 2008, and by the end of 2008 had stopped growing entirely. In 2009, we experienced a 15% decline in global ADRs due primarily to weak travel demand and continued supply expansion. In the first half of 2010, ADRs began to stabilize and for Expedia were flat on a year over year basis.

While lower occupancies have historically increased the availability of discounted hotel rooms, and a lower rate of ADR growth can positively impact underlying room night growth, lower ADRs also decrease our revenue per room night as our

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remuneration varies proportionally with the room price. Revenue per room night in 2009 declined 17% primarily due to the downward movement in ADRs as well as adverse movements in foreign exchange rates and lower fees. In the first half of 2010, ADRs have been generally flat to slightly increasing on our sites while revenue per room night is down 6%. The decrease in revenue per room night is due in part to adverse movements in the foreign exchange rates, lower consumer fees and customer refunds as a result of the Icelandic volcano.

### *Online Travel*

Increased usage and familiarity with the internet have driven rapid growth in online penetration of travel expenditures. According to PhoCusWright, an independent travel, tourism and hospitality research firm, in 2009 approximately 56% of U.S. leisure, unmanaged and corporate travel expenditures occurred online, compared with approximately 32% of European travel. Online penetration in the Asia Pacific region is estimated to lag behind that of Europe. These penetration rates have increased over the past few years, and are expected to continue growing. This significant growth has attracted many competitors to online travel. This competition has intensified in recent years, and the industry is expected to remain highly competitive for the foreseeable future.

In addition to the growth of online travel agencies, airlines and lodging companies have aggressively pursued direct online distribution of their products and services, and supplier growth outpaced online agency growth for several years. As a result, according to PhoCusWright, by 2009 travel supplier sites accounted for 61% of total online travel spend in the United States. More recently, due to booking fee reductions and eliminations, online agents appear to have regained some share of overall online travel spend. Our visibility on whether these share gains continue once we pass the anniversary of the fee actions in 2010 is limited.

Differentiation among the various website offerings has narrowed dramatically in the past several years, and the travel landscape has grown extremely competitive, with the need for competitors to generally differentiate their offerings on features other than price. Competitive entrants such as metasearch companies have in some cases been able to introduce differentiated features and content compared with the legacy online travel agency companies; although in most cases they are not providing actual travel booking services. Some of these competitors have raised significant amounts of capital and have begun to aggressively market their service offerings. In early 2009, TripAdvisor.com launched a competitive metasearch travel offering featuring a Fee Estimator enabling customers to see the price of their flight including various airline fees such as baggage charges. In addition, beginning in 2009 we have seen increased interest in the online travel industry from search engine companies as evidenced by recent innovations and acquisitions by companies such as Google and Microsoft.

The online travel industry has also seen the development of alternative business models and variations in the timing of payment by travelers and to suppliers, which in some cases places pressure on historical business models. In particular, the agency hotel model has seen rapid adoption in Europe, and Expedia introduced a competitive offering in the spring of 2009. While agency hotel is an important component of our European strategy, we expect it will take time to gain traction with incremental hotel suppliers, and for Expedia to drive meaningful demand to those hotels.

Intense competition has also historically led to aggressive marketing spend by the travel suppliers and intermediaries, and a meaningful reduction in our overall marketing efficiencies and operating margins. In 2009, we experienced a reversal of these trends due to several factors including the softer macro environment, lower ad rates and a pullback in spend by some of our online competitors impacted by lower fee revenues. Our marketing spend in the first half of 2010 has returned to a more normalized environment as the economy improves. We believe that over the long term we can manage the direct portion of our sales and marketing expense largely in line with revenue growth.

### *Strategy*

We play a fundamental role in facilitating travel, whether for leisure, unmanaged business or managed business travelers. We are committed to providing travelers, travel suppliers and advertisers the world over with the best set of resources to serve their travel needs by leveraging Expedia's critical assets—our brand portfolio, our technology and commitment to continuous innovation, our global reach and our breadth of product offering. In addition, we intelligently utilize our growing base of knowledge about destinations, activities, suppliers and travelers and our central position in the travel value chain to more effectively merchandise our travel offerings.

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A discussion of the critical assets that we leverage in achieving our business strategy follows:

*Portfolio of Travel Brands.* We seek to appeal to the broadest possible range of travelers, suppliers and advertisers through our collection of industry-leading brands. We target several different demographics, from the value-conscious traveler through our Hotwire brand to luxury travelers seeking a high-touch, customized vacation package through our Classic Vacations brand.

We believe our flagship Expedia brand appeals to the broadest range of travelers, with our extensive product offering ranging from single item bookings of discounted product to dynamic bundling of higher-end travel packages. Our Hotels.com site and its international versions target travelers with premium hotel content such as 360-degree tours and hotel reviews. In the United States, Hotels.com generally appeals to travelers with shorter booking windows who prefer to drive to their destinations, and who make a significant portion of their travel bookings over the telephone.

Through Egencia, we make travel products and services available on a managed basis to corporate travelers in North America, Europe and the Asia Pacific region. Further, our TripAdvisor Media Network allows us to reach a broad range of travelers with travel opinions and user-generated content.

We believe our appeal to suppliers and advertisers is further enhanced by our geographic breadth and range of business models, allowing them to offer their products and services to the industry's broadest range of travelers using our various agency, merchant and advertising business models. We intend to continue supporting and investing in our brand portfolio, geographic footprint and business models for the benefit of our travelers, suppliers and advertisers.

*Technology and Continuous Innovation.* Expedia has an established tradition of technology innovation, from Expedia.com's inception as a division of Microsoft to our introduction of more recent innovations such as Expedia's introduction of its Expedia Easy Manage agency hotel program, Media Solutions introduction of rich media display ads called StorePoint Expandables, TripAdvisor's launch of its new hotel Business Listings product and new mobile sites in 17 countries and 11 different languages, Expedia.com's introduction of Unpublished Rates opaque hotel inventory and Hotwire's introduction of its One-Way car product. We intend to continue innovating on behalf of our travelers, suppliers and advertisers with particular focus on improving the traveler experience, supplier integration and presentation, platform improvements, search engine marketing and search engine optimization.

*Global Reach.* Our Expedia, Hotels.com and TripAdvisor Media Network brands operate both in the United States and internationally. We also offer Chinese travelers an array of products and services through our majority ownership in eLong and through our TripAdvisor brands daodao.com and kuxun.cn, and we offer hotel bookings to European-based travelers through our wholly-owned subsidiary Venere, which we acquired in the third quarter of 2008. During the first half of 2010, approximately 34% of our worldwide gross bookings and 35% of worldwide revenue were international.

Egencia, our corporate travel business, currently operates in over 30 countries around the world both through dedicated points of sale as well as through the Egencia Global Alliance. We believe the corporate travel sector represents a large opportunity for Expedia, and we believe we offer a compelling technology solution to businesses seeking to optimize travel costs and improve their employees' travel experiences. We intend to continue investing in and expanding the geographic footprint and technology infrastructure of Egencia.

In expanding our global reach, we leverage significant investments in technology, operations, brand building, supplier relationships and other initiatives that we have made since the launch of Expedia.com in 1996. We intend to continue leveraging this investment when launching additional points of sale in new countries, introducing new website features, adding supplier products and services, and offering proprietary and user-generated content for travelers.

Our scale of operations enhances the value of technology innovations we introduce on behalf of our travelers and suppliers. As an example, our traveler review feature whereby our travelers have created millions of qualified reviews of hotel properties is able to accumulate a larger base of reviews due to the higher base of online traffic that frequents our various websites. In addition, our increasing scale enhances our websites' appeal to travel and non-travel advertisers.

We intend to continue investing in and growing our international points of sale. We anticipate launching points of sale in additional countries where we find large travel markets and rapid growth of online commerce. Future launches may occur under any of our brands, or through acquisition of third party brands, as in the case of eLong, Venere and Egencia.



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*Breadth of Product Offering.* We offer a comprehensive array of innovative travel products and services to our travelers. We plan to continue improving and growing these offerings, as well as expand them to our worldwide points of sale over time. Travelers can interact with us how and when they prefer, including via our 24/7 1-800 telesales service, which is an integral part of the Company's appeal to travelers.

In the first half of 2010, over 60% of our revenue came from transactions involving the booking of hotel reservations, with approximately 13% of our worldwide revenue derived from the sale of airline tickets. We facilitate travel products and services either as stand-alone products or as part of package transactions. We have emphasized growing our merchant hotel and packages businesses as these result in higher revenue per transaction; however, we are also working to grow our global agency hotel business in Europe, given the success of the agency model with both suppliers and travelers in that region. We also seek to continue diversifying our revenue mix beyond core air and hotel products to car rental, destination services, cruise and other product offerings. We have been working toward and will continue to work toward increasing the mix of advertising and media revenue from both the expansion of our TripAdvisor Media Network, as well as increasing advertising revenue from our worldwide websites such as Expedia.com and Hotels.com, which have historically been focused on transaction revenue. During the first half of 2010, advertising and media revenue accounted for approximately 13% of worldwide revenue.

### *Seasonality*

We generally experience seasonal fluctuations in the demand for our travel products and services. For example, traditional leisure travel bookings are generally the highest in the first three quarters as travelers plan and book their spring, summer and holiday travel. The number of bookings typically decreases in the fourth quarter. Because revenue in our merchant business is generally recognized when the travel takes place rather than when it is booked, revenue typically lags bookings by several weeks or longer. As a result, revenue is typically the lowest in the first quarter and highest in the third quarter. The continued growth of our international operations or a change in our product mix may influence the typical trend of our seasonality in the future.

### *Critical Accounting Policies and Estimates*

Critical accounting policies and estimates are those that we believe are important in the preparation of our consolidated financial statements because they require that we use judgment and estimates in applying those policies. We prepare our consolidated financial statements and accompanying notes in accordance with generally accepted accounting principles in the United States ( "GAAP" ). Preparation of the consolidated financial statements and accompanying notes requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements as well as revenue and expenses during the periods reported. We base our estimates on historical experience, where applicable, and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from our estimates under different assumptions or conditions.

There are certain critical estimates that we believe require significant judgment in the preparation of our consolidated financial statements. We consider an accounting estimate to be critical if:

It requires us to make an assumption because information was not available at the time or it included matters that were highly uncertain at the time we were making the estimate; and

Changes in the estimate or different estimates that we could have selected may have had a material impact on our financial condition or results of operations.

For additional information about our critical accounting policies and estimates, see the disclosure included in our Annual Report on Form 10-K for the year ended December 31, 2009.

### *New Accounting Pronouncements*

For a discussion of new accounting pronouncements, see Note 2 – Summary of Significant Accounting Policies in the notes to the consolidated financial statements.

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### ***Occupancy Taxes***

We are currently involved in 50 lawsuits brought by or against states, cities and counties over issues involving the payment of hotel occupancy taxes. We continue to defend these lawsuits vigorously. With respect to the principal claims in these matters, we believe that the ordinances at issue do not apply to the services we provide, namely the facilitation of hotel reservations, and, therefore, that we do not owe the taxes that are claimed to be owed. We believe that the ordinances at issue generally impose occupancy and other taxes on entities that own, operate or control hotels (or similar businesses) or furnish or provide hotel rooms or similar accommodations.

Recent developments include:

Certain new lawsuits have been brought, including suits by the City of Santa Monica, California; the Town of Hilton Head Island, South Carolina; Baltimore County, Maryland; and the City of Philadelphia, Pennsylvania, as further described below.

*City of San Diego, California Litigation.* The San Diego hearing officer held in favor of the City of San Diego at the administrative level and held that occupancy taxes are due. We have appealed the decision. This action is consolidated in the Superior Court of the State of California, Los Angeles with the pending claims by the cities of Anaheim, San Francisco and Los Angeles, and further proceedings will take place in this court.

*City of Atlanta, Georgia Litigation.* The trial court ruled on the parties' cross-motions for summary judgment. The court held that the online travel companies are not innkeepers and therefore are not subject to the Atlanta ordinance. The court held that the online travel companies are third-party tax collectors and that tax should be collected on the online travel companies' fees. The court issued an injunction requiring the online travel companies to collect and remit taxes on their fees.

Settlements or settlements in principle of the lawsuits brought by Worcester County, Maryland; the County of Monroe, Florida; and the suit brought by the City of Charleston, Town of Mt. Pleasant and City of North Myrtle Beach, South Carolina have been reached. For additional information on recent developments, see Part II, Item 1, Legal Proceedings.

We have established a reserve for the potential settlement of issues related to hotel occupancy tax litigation, consistent with applicable accounting principles and in light of all current facts and circumstances, in the amount of \$27 million as of June 30, 2010, which includes amounts expected to be paid in connection with the settlements listed above, and \$21 million as of December 31, 2009. A variety of factors could affect the ultimate amount we pay, if any, in connection with any of the occupancy tax-related matters.

In addition, certain jurisdictions may require us to pay tax assessments, including occupancy tax assessments, prior to contesting any such assessments. This requirement is commonly referred to as "pay-to-play." Payment of these amounts is not an admission that the taxpayer believes it is subject to such taxes. During 2009, we expensed \$48 million related to monies paid in advance of litigation in occupancy tax proceedings in the city of San Francisco. We do not believe that the amounts we retain as compensation are subject to the city's hotel occupancy tax ordinance. If we prevail in the litigation, the city will be required to repay these amounts, plus interest. However, any significant pay-to-play payment or litigation loss could negatively impact our liquidity.

### ***Segments***

We have three reportable segments: Leisure, TripAdvisor Media Network and Egencia. We determined our segments based on how our chief operating decision makers manage our business, make operating decisions and evaluate operating performance.

Our Leisure segment provides a full range of travel and advertising services to our worldwide customers through a variety of brands including: Expedia.com and Hotels.com in the United States and localized Expedia and Hotels.com websites throughout the world, Expedia Affiliate Network, Hotwire.com, Venere, eLong and Classic Vacations. Our TripAdvisor Media Network segment provides advertising services to travel suppliers on its websites, which aggregate traveler opinions and unbiased travel articles about cities, hotels, restaurants and activities in a variety of destinations through tripadvisor.com and its localized international versions as well as through its various travel media content properties within TripAdvisor Media Network. Our Egencia segment provides managed travel services to corporate customers in North America, Europe,

and the Asia Pacific region.

***Operating Metrics***

Our operating results are affected by certain metrics, such as gross bookings and revenue margin, which we believe are necessary for an understanding and evaluation of Expedia's Leisure and Egencia segments. Gross bookings represent the



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total retail value of transactions booked for both agency and merchant transactions, recorded at the time of booking reflecting the total price due for travel by travelers, including taxes, fees and other charges, and are generally reduced for cancellations and refunds. As travelers have increased their use of the internet to book travel arrangements, we have generally seen our gross bookings increase, reflecting the growth in the online travel industry and our business acquisitions. Revenue margin is defined as revenue as a percentage of gross bookings.

*Gross Bookings and Revenue Margin*

|                                          | Three months ended June 30, |          |          | Six months ended June 30, |           |          |
|------------------------------------------|-----------------------------|----------|----------|---------------------------|-----------|----------|
|                                          | 2010                        | 2009     | % Change | 2010                      | 2009      | % Change |
|                                          | (\$ in millions)            |          |          | (\$ in millions)          |           |          |
| <u>Gross Bookings</u>                    |                             |          |          |                           |           |          |
| Leisure                                  | \$ 6,194                    | \$ 5,293 | 17%      | \$ 12,355                 | \$ 10,198 | 21%      |
| TripAdvisor Media Network <sup>(1)</sup> |                             |          | N/A      |                           |           | N/A      |
| Egencia                                  | 489                         | 330      | 48%      | 960                       | 651       | 47%      |
| Total gross bookings                     | \$ 6,683                    | \$ 5,623 | 19%      | \$ 13,315                 | \$ 10,849 | 23%      |
| <u>Revenue Margin</u>                    |                             |          |          |                           |           |          |
| Leisure                                  | 11.6%                       | 13.0%    |          | 10.8%                     | 12.2%     |          |
| TripAdvisor Media Network <sup>(1)</sup> | N/A                         | N/A      |          | N/A                       | N/A       |          |
| Egencia                                  | 7.3%                        | 8.1%     |          | 7.2%                      | 7.9%      |          |
| Total revenue margin <sup>(1)</sup>      | 12.5%                       | 13.7%    |          | 11.7%                     | 13.0%     |          |

(1) TripAdvisor Media Network, which is comprised of media businesses that differ from our transaction-based websites and our Egencia business, does not have associated gross bookings or revenue margin. However, third-party revenue from the TripAdvisor Media Network is included in revenue used to calculate total revenue margin.

The increase in worldwide gross bookings for the three and six months ended June 30, 2010, as compared to the same periods in 2009, was primarily due to a 10% and 14% increases in transactions and a 17% and 13% increase in average airfares.

The decrease in revenue margin for the three and six months ended June 30, 2010, as compared to the same periods in 2009, was primarily due to a higher mix of air bookings, which have a lower revenue margin than our other products and services. The higher mix of air bookings is due in part to an increase in air ticket prices.

**Results of Operations***Revenue*

|                                                 | Three months ended June 30, |        |          | Six months ended June 30, |          |          |
|-------------------------------------------------|-----------------------------|--------|----------|---------------------------|----------|----------|
|                                                 | 2010                        | 2009   | % Change | 2010                      | 2009     | % Change |
|                                                 | (\$ in millions)            |        |          | (\$ in millions)          |          |          |
| Leisure                                         | \$ 716                      | \$ 690 | 4%       | \$ 1,329                  | \$ 1,249 | 6%       |
| TripAdvisor Media Network (Third-party revenue) | 82                          | 53     | 55%      | 154                       | 105      | 47%      |
| Egencia                                         | 36                          | 27     | 33%      | 69                        | 52       | 34%      |
| Total revenue                                   | \$ 834                      | \$ 770 | 8%       | \$ 1,552                  | \$ 1,405 | 10%      |

Revenue increased for the three and six months ended June 30, 2010, compared to the same periods in 2009, primarily due to an increase in worldwide hotel revenue within our Leisure segment as well as an increase in advertising and media revenue within our TripAdvisor Media Network and Leisure segments.



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Worldwide hotel revenue increased 4% and 8% for the three and six months ended June 30, 2010, compared to the same periods in 2009. The increase was primarily due to a 12% and 14% increase in room nights stayed, including rooms delivered as a component of packages, partially offset by a 7% and 6% decline in revenue per room night. Revenue per room night decreased due to the impact from foreign exchange, customer refunds related to the Icelandic volcano and lower hotel services fees for the three and six months ended June 30, 2010 compared to the same periods in 2009.

Worldwide air revenue increased 13% and 9% for the three and six months ended June 30, 2010, compared to the same periods in 2009. The increase for the three months ended June 30, 2010 was due to a 6% increase in air tickets sold combined with a 7% increase in revenue per air ticket. The increase for the six months ended June 30, 2010 was due to a 14% increase in air tickets sold, partially offset by a 4% decrease in revenue per air ticket. Revenue per air ticket increased during the three month period primarily as a result of an increase in average airfares, while it decreased for the six month period due to our elimination of booking fees on Expedia.com beginning in March 2009, partially offset by an increase in average airfares.

The remaining worldwide revenue other than hotel and air discussed above, which includes advertising and media, car rental, destination services, agency cruise, increased by 17% and 18% for the three and six months ended June 30, 2010, compared to the same periods in 2009, primarily due to an increase in our advertising and media revenue.

In addition to the above segment and product revenue discussion, our revenue by business model is as follows:

|                                      | Three months ended June 30, |        |          | Six months ended June 30, |          |          |
|--------------------------------------|-----------------------------|--------|----------|---------------------------|----------|----------|
|                                      | 2010                        | 2009   | % Change | 2010                      | 2009     | % Change |
|                                      | (\$ in millions)            |        |          | (\$ in millions)          |          |          |
| <b>Revenue by Business Model</b>     |                             |        |          |                           |          |          |
| Merchant                             | \$ 548                      | \$ 527 | 4%       | \$ 999                    | \$ 936   | 7%       |
| Agency                               | 178                         | 165    | 9%       | 347                       | 319      | 9%       |
| Advertising and media <sup>(1)</sup> | 108                         | 78     | 39%      | 206                       | 150      | 38%      |
| Total revenue                        | \$ 834                      | \$ 770 | 8%       | \$ 1,552                  | \$ 1,405 | 10%      |

(1) Includes third-party revenue from TripAdvisor Media Network as well as our Leisure transaction-based websites.

Merchant revenue increased for the three and six months ended June 30, 2010, compared to the same periods in 2009, due to the increase in merchant hotel revenue primarily driven by an increase in room nights stayed.

Agency revenue increased for the three and six months ended June 30, 2010, compared to the same periods in 2009, due to an increase in air revenue.

Advertising and media revenue increased during the three and six months ended June 30, 2010, compared to the same periods in 2009, primarily due to a 55% and 47% increase in advertising revenue at TripAdvisor Media Network.

### Cost of Revenue

|                        | Three months ended June 30, |        |          | Six months ended June 30, |        |          |
|------------------------|-----------------------------|--------|----------|---------------------------|--------|----------|
|                        | 2010                        | 2009   | % Change | 2010                      | 2009   | % Change |
|                        | (\$ in millions)            |        |          | (\$ in millions)          |        |          |
| Customer operations    | \$ 82                       | \$ 72  | 14%      | \$ 160                    | \$ 140 | 15%      |
| Credit card processing | 53                          | 43     | 24%      | 98                        | 83     | 18%      |
| Data center and other  | 34                          | 34     | (2%)     | 69                        | 69     | (1%)     |
| Total cost of revenue  | \$ 169                      | \$ 149 | 13%      | \$ 327                    | \$ 292 | 12%      |

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| % of revenue | 20.2% | 19.3% | 21.0% | 20.8% |
|--------------|-------|-------|-------|-------|
|--------------|-------|-------|-------|-------|

Cost of revenue primarily consists of (1) customer operations, including our customer support and telesales as well as fees to air ticket fulfillment vendors, (2) credit card processing, including merchant fees, charge backs and fraud, and (3) other costs, primarily including data center costs to support our websites, certain promotions, destination supply, and stock-based compensation.

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During the three and six months ended June 30, 2010, the primary drivers of the increase in cost of revenue expense were higher costs related to credit card processing, telesales and customer service to support the growth in our transaction volumes. The three months ended June 30, 2010 also increased as a result of expenses related to the Icelandic volcano and airline strike activity as well as investments made during the second quarter, such as call center migration. We expect cost of revenue to increase in absolute dollars but decrease as a percentage of revenue for full year 2010.

*Selling and Marketing*

|                                    | Three months ended June 30, |               |           | Six months ended June 30, |               |            |
|------------------------------------|-----------------------------|---------------|-----------|---------------------------|---------------|------------|
|                                    | 2010                        | 2009          | % Change  | 2010                      | 2009          | % Change   |
|                                    | (\$ in millions)            |               |           | (\$ in millions)          |               |            |
| Direct costs                       | \$ 216                      | \$ 204        | 6%        | \$ 418                    | \$ 372        | 12%        |
| Indirect costs                     | 81                          | 67            | 19%       | 160                       | 135           | 18%        |
| <b>Total selling and marketing</b> | <b>\$ 297</b>               | <b>\$ 271</b> | <b>9%</b> | <b>\$ 578</b>             | <b>\$ 507</b> | <b>14%</b> |

% of revenue 35.6% 35.3% 37.2% 36.1%

Selling and marketing expense primarily relates to direct costs, including traffic generation costs from search engines and internet portals, television, radio and print spending, private label and affiliate program commissions, public relations and other costs. The remainder of the expense relates to indirect costs, including personnel and related overhead in our Partner Services Group ( PSG ), TripAdvisor Media Network and Egencia and stock-based compensation costs.

Selling and marketing expenses increased \$26 million and \$71 million during the three and six months ended June 30, 2010, compared to the same periods in 2009, due to an increase in affiliate marketing expenses, higher personnel costs primarily related to our PSG staff and our global advertising and media businesses, expenses associated with the opening of a new global headquarters for our lodging supply group and an increase in online spending for Hotwire. We expect selling and marketing expense to increase in absolute dollars and as a percentage of revenue for full year 2010 in part due to approximately \$20 million in relocation and other costs related to the opening of a new global headquarters for our lodging supply group.

*Technology and Content*

|                                                    | Three months ended June 30, |              |            | Six months ended June 30, |               |            |
|----------------------------------------------------|-----------------------------|--------------|------------|---------------------------|---------------|------------|
|                                                    | 2010                        | 2009         | % Change   | 2010                      | 2009          | % Change   |
|                                                    | (\$ in millions)            |              |            | (\$ in millions)          |               |            |
| Personnel and overhead                             | \$ 44                       | \$ 42        | 5%         | \$ 91                     | \$ 83         | 10%        |
| Depreciation and amortization of technology assets | 20                          | 16           | 21%        | 36                        | 32            | 13%        |
| Other                                              | 23                          | 20           | 20%        | 47                        | 41            | 15%        |
| <b>Total technology and content</b>                | <b>\$ 87</b>                | <b>\$ 78</b> | <b>12%</b> | <b>\$ 174</b>             | <b>\$ 156</b> | <b>12%</b> |

% of revenue 10.5% 10.1% 11.2% 11.1%

Technology and content expense includes product development and content expense, as well as information technology costs to support our infrastructure, back-office applications and overall monitoring and security of our networks, and is principally comprised of personnel and overhead, depreciation and amortization of technology assets including hardware, and purchased and internally developed software, and other costs including licensing and maintenance expense and stock-based compensation.

The increase of \$9 million and \$18 million in technology and content expense during the three and six months ended June 30, 2010, compared to the same periods in 2009, was primarily due to increased personnel costs to support our worldwide transaction-based businesses and TripAdvisor Media Network businesses as well as an increase in depreciation expense associated with an increase in our capital expenditures. We expect technology and content expense to increase in absolute dollars and as a percentage of revenue for full year 2010.



**Table of Contents***General and Administrative*

|                                         | Three months ended June 30, |              |            | Six months ended June 30, |               |            |
|-----------------------------------------|-----------------------------|--------------|------------|---------------------------|---------------|------------|
|                                         | 2010                        | 2009         | % Change   | 2010                      | 2009          | % Change   |
|                                         | (\$ in millions)            |              |            | (\$ in millions)          |               |            |
| Personnel and overhead                  | \$ 43                       | \$ 39        | 10%        | \$ 83                     | \$ 75         | 10%        |
| Professional fees and other             | 36                          | 28           | 28%        | 67                        | 60            | 12%        |
| <b>Total general and administrative</b> | <b>\$ 79</b>                | <b>\$ 67</b> | <b>17%</b> | <b>\$ 150</b>             | <b>\$ 135</b> | <b>11%</b> |

% of revenue 9.5% 8.8% 9.7% 9.6%

General and administrative expense consists primarily of personnel-related costs, including our executive leadership, finance, legal and human resource functions as well as fees for professional services including legal, tax and accounting, and other costs including stock-based compensation.

The \$12 million increase in general and administrative expense during the three months ended June 30, 2010, compared to the same period in 2009, was due primarily to an increase in our reserve for the potential settlement of issues related to hotel occupancy taxes and higher personnel expenses, partially offset by a reduction in legal and related fees primarily due to the timing of litigation. The \$15 million increase for the six months ended June 30, 2010 was due to similar factors, with higher personnel expenses being the primary driver of the year over year increase. We expect general and administrative expense to increase in absolute dollars but decrease as a percentage of revenue for full year 2010.

*Amortization of Intangible Assets*

|                                   | Three months ended June 30, |      |          | Six months ended June 30, |       |          |
|-----------------------------------|-----------------------------|------|----------|---------------------------|-------|----------|
|                                   | 2010                        | 2009 | % Change | 2010                      | 2009  | % Change |
|                                   | (\$ in millions)            |      |          | (\$ in millions)          |       |          |
| Amortization of intangible assets | \$ 8                        | \$ 9 | (10%)    | \$ 17                     | \$ 18 | (5%)     |
| % of revenue                      | 1.0%                        | 1.2% |          | 1.1%                      | 1.3%  |          |

*Restructuring Charges*

During the three and six months of 2009, in conjunction with the reorganization of our business around our global brands, we recognized \$6 million and \$15 million in restructuring charges primarily related to employee severance and related benefits. No such charges were recognized during the first half of 2010. For additional information, see Note 7 Restructuring Charges in the notes to the consolidated financial statements.

*Occupancy Tax Assessments and Legal Reserves*

During the three and six months ended June 30, 2009, we recognized \$55 million, which was reduced to \$48 million subsequently in 2009, related to monies paid in advance of litigation in the San Francisco occupancy tax proceedings and an accrual of \$19 million for the settlement of the Expedia consumer class action lawsuit. For additional information, see Note 9 Commitments and Contingencies in the notes to the consolidated financial statements.

*Operating Income*

|                  | Three months ended June 30, |        |          | Six months ended June 30, |        |          |
|------------------|-----------------------------|--------|----------|---------------------------|--------|----------|
|                  | 2010                        | 2009   | % Change | 2010                      | 2009   | % Change |
|                  | (\$ in millions)            |        |          | (\$ in millions)          |        |          |
| Operating income | \$ 194                      | \$ 115 | 69%      | \$ 306                    | \$ 208 | 47%      |
| % of revenue     | 23.2%                       | 14.9%  |          | 19.7%                     | 14.8%  |          |

Operating income increased for the three and six months ended June 30, 2010, compared to the same periods in 2009, primarily due to occupancy tax assessments and legal reserves and restructuring charges recorded in 2009 that did not recur and an increase in revenue, which

was substantially offset by a corresponding increase to costs and expenses.



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### Interest Income and Expense

|                                                                                                                                                       | Three months ended June 30, |      |          | Six months ended June 30, |      |          |
|-------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------|------|----------|---------------------------|------|----------|
|                                                                                                                                                       | 2010                        | 2009 | % Change | 2010                      | 2009 | % Change |
|                                                                                                                                                       | (\$ in millions)            |      |          | (\$ in millions)          |      |          |
| Interest income                                                                                                                                       | \$ 1                        | \$ 1 | (14%)    | \$ 2                      | \$ 4 | (56%)    |
| Interest expense                                                                                                                                      | (20)                        | (21) | (3%)     | (41)                      | (42) | (2%)     |
| Interest income decreased for the six months ended June 30, 2010, compared to the same periods in 2009 primarily due to lower average interest rates. |                             |      |          |                           |      |          |

### Other, Net

Other, net is comprised of the following:

|                                                   | Three months ended June 30, |         |          | Six months ended June 30, |         |          |
|---------------------------------------------------|-----------------------------|---------|----------|---------------------------|---------|----------|
|                                                   | 2010                        | 2009    | % Change | 2010                      | 2009    | % Change |
|                                                   | (\$ in millions)            |         |          | (\$ in millions)          |         |          |
| Foreign exchange rate gains/(losses), net         | \$ 1                        | \$ (15) | (107%)   | \$ 2                      | \$ (21) | (110%)   |
| Noncontrolling investment basis adjustment        |                             | (5)     | (100%)   |                           | (5)     | (100%)   |
| Equity income/(loss) of unconsolidated affiliates |                             | 1       | (100%)   | (1)                       |         | N/A      |
| Total other, net                                  | \$ 1                        | \$ (19) | (106%)   | \$ 1                      | \$ (26) | (106%)   |

### Provision for Income Taxes

|                            | Three months ended June 30, |         |          | Six months ended June 30, |         |          |
|----------------------------|-----------------------------|---------|----------|---------------------------|---------|----------|
|                            | 2010                        | 2009    | % Change | 2010                      | 2009    | % Change |
|                            | (\$ in millions)            |         |          | (\$ in millions)          |         |          |
| Provision for income taxes | \$ (60)                     | \$ (34) | 75%      | \$ (92)                   | \$ (62) | 49%      |
| Effective tax rate         | 34.3%                       | 45.1%   |          | 34.3%                     | 43.0%   |          |

We determine our provision for income taxes for interim periods using an estimate of our annual effective rate. We record any changes to the estimated annual rate in the interim period in which the change occurs, including discrete tax items.

The decrease in the effective rate for the three and six months ended June 30, 2010 as compared to the same periods in 2009 was primarily due to an increase in estimated earnings in jurisdictions outside the United States, the non-deductible portion of occupancy tax assessments accrued during the second quarter of 2009 as well as a non-deductible loss on one of our equity method investment and, to a lesser extent, lower accrual related to uncertain tax positions.

Our effective tax rate was 34.3% for the three and six months ended June 30, 2010, which is lower than the 35% federal statutory rate primarily due to an increase in estimated earnings in jurisdictions outside the United States, partially offset by state income taxes and accruals related to uncertain tax positions.

Our effective tax rate was 45.1% and 43.0% for the three and six months ended June 30, 2009, which is higher than the 35% federal statutory rate primarily due to state income taxes and non-deductible expenses described above.

### Financial Position, Liquidity and Capital Resources

Our principal sources of liquidity are cash flows generated from operations; our cash and cash equivalents and short-term investment balances, which were \$1.0 billion and \$688 million at June 30, 2010 and December 31, 2009, including \$132 million and \$148 million of cash and

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short-term investment balances of majority-owned subsidiaries; and our revolving credit facility.

In February 2010, we entered into a new \$750 million, three-year revolving credit facility, replacing our prior credit facility. Pricing is based on the Company's credit ratings, with drawn amounts bearing interest at LIBOR plus 300 basis points, and undrawn amounts bearing interest at 50 basis points. We incurred approximately \$8 million in fees associated with the new facility, which will be amortized over its life of three years. As of June 30, 2010, \$721 million was available under the facility representing the total \$750 million facility less \$29 million of outstanding stand-by letters of credit. We had an additional \$11 million of outstanding stand-by letters of credit related to the prior facility.

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Our credit ratings are periodically reviewed by rating agencies. In October 2009, our long-term ratings from Moody's and Standard and Poor's were raised to Ba1 and BBB-, respectively. Both agencies maintain a stable ratings outlook. Changes in our operating results, cash flows, financial policy or financial position could impact the ratings assigned by the various rating agencies. Should our credit ratings be adjusted downward, we may incur higher costs to borrow, which could have a material impact on our financial condition and results of operations.

Under the merchant model, we receive cash from travelers at the time of booking and we record these amounts on our consolidated balance sheets as deferred merchant bookings. We pay our airline suppliers related to these merchant model bookings generally within a few weeks after completing the transaction, but we are liable for the full value of such transactions until the flights are completed. For most other merchant bookings, which is primarily our merchant hotel business, we pay after the travelers' use and subsequent billing from the hotel suppliers. Therefore, generally we receive cash from the traveler prior to paying our suppliers, and this operating cycle represents a working capital source of cash to us. As long as the merchant hotel business grows, we expect that changes in working capital will positively impact operating cash flows. If this business model declines relative to our other businesses, or if there are changes to the model or booking patterns which compress the time of receipts of cash from travelers to payment to suppliers, our working capital benefits could be reduced.

Seasonal fluctuations in our merchant hotel bookings affect the timing of our annual cash flows. During the first half of the year, hotel bookings have traditionally exceeded stays, resulting in much higher cash flow related to working capital. During the second half of the year, this pattern reverses and cash flows are typically negative. While we expect the impact of seasonal fluctuations to continue, merchant hotel growth rates or changes to the hotel business model or booking patterns as discussed above may affect working capital, which might counteract or intensify the anticipated seasonal fluctuations.

As of June 30, 2010, we had a deficit in our working capital of \$772 million, compared to a deficit of \$610 million as of December 31, 2009 primarily due to financing activities including stock repurchases and dividend payments.

We continue to invest in the development and expansion of our operations. Ongoing investments include but are not limited to improvements to infrastructure, which include our servers, networking equipment and software, release improvements to our software code, platform migrations and consolidations and search engine marketing and optimization efforts. Our future capital requirements may include capital needs for acquisitions, share repurchases, dividend payments or expenditures in support of our business strategy; thus reducing our cash balance and/or increasing our debt.

Our cash flows are as follows:

|                                                                      | <b>Six months ended June 30,</b> |                      |                  |
|----------------------------------------------------------------------|----------------------------------|----------------------|------------------|
|                                                                      | <b>2010</b>                      | <b>2009</b>          | <b>\$ Change</b> |
|                                                                      |                                  | <b>(In millions)</b> |                  |
| Cash provided by (used in):                                          |                                  |                      |                  |
| Operating activities                                                 | \$ 933                           | \$ 845               | \$ 88            |
| Investing activities                                                 | (491)                            | 35                   | (526)            |
| Financing activities                                                 | (241)                            | (678)                | 437              |
| Effect of foreign exchange rate changes on cash and cash equivalents | (48)                             | (5)                  | (43)             |

For the six months ended June 30, 2010, net cash provided by operating activities increased by \$88 million primarily due to a decrease in income tax payments and higher operating income after adjusting for the impacts of depreciation and amortization.

We used \$526 million more in cash for investing activities for the six months ended June 30, 2010 compared to the prior year period primarily due to an increased use of cash of \$428 million related to net purchases of investments, an increase in capital expenditures of \$31 million and an increase in net cash paid for acquisitions of \$28 million.

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Cash used in financing activities for the six months ended June 30, 2010 primarily included cash paid to acquire shares of \$199 million, including the repurchased shares under the 2006 authorization discussed below, as well as \$40 million in cash dividend payments, partially offset by \$31 million of proceeds from the exercise of equity awards. Cash used in financing activities for the six months ended June 30, 2009 primarily included the repayment of \$650 million of borrowings under the prior credit facility.

In 2006, our Board of Directors authorized a share repurchase of up to 20 million outstanding shares of our common stock. There is no fixed termination date for the repurchase. During the first half of 2010, we repurchased, through open market transactions, 8.4 million shares under this authorization for a total cost of \$188 million, representing an average repurchase price of \$22.46 per share. As of June 30, 2010, 11.6 million shares remain authorized for repurchase. No additional repurchases have been made under this authorization as of July 29, 2010.

In the first and second quarters of 2010, the Executive Committee, acting on behalf of the Board of Directors, declared and we paid quarterly cash dividends of \$0.07 per share of outstanding common stock payable to stockholders of record as of the close of business on March 11, 2010 and May 27, 2010. In addition, on July 26, 2010, the Executive Committee, acting on behalf of the Board of Directors, declared a quarterly cash dividend of \$0.07 per share of outstanding common stock to stockholders of record as of the close of business on August 26, 2010. Future declarations of dividends are subject to final determination by our Board of Directors.

The effect of foreign exchange on our cash balances denominated in foreign currency for the six months ended June 30, 2010 showed a net decrease of \$48 million reflecting depreciation in currencies and higher foreign-denominated cash balances in the current year period.

We also have a shelf registration statement filed with the SEC under which Expedia, Inc. may offer from time to time debt securities, guarantees of debt securities, preferred stock, common stock or warrants. The shelf registration statement expires on October 15, 2010.

In our opinion, available cash, funds from operations and available borrowings will provide sufficient capital resources to meet our foreseeable liquidity needs. There can be no assurance, however, that the cost or availability of future borrowings, including refinancings, if any, will be available on terms acceptable to us.

### ***Contractual Obligations, Commercial Commitments and Off-balance Sheet Arrangements***

There have been no material changes outside the normal course of business to our contractual obligations and commercial commitments since December 31, 2009. Other than our contractual obligations and commercial commitments, we did not have any off-balance sheet arrangements as of June 30, 2010 or December 31, 2009.

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**Part I. Item 3. Quantitative and Qualitative Disclosures About Market Risk**

***Market Risk Management***

*Interest Rate Risk*

During the first quarter of 2010, we began investing in investment grade corporate debt securities and, as of June 30, 2010, we had \$125 million of available for sale investments. Additionally, as of June 30, 2010 our investments included a \$33 million bearer deposit note classified as held to maturity. We performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of these investments assuming an adverse change of 100 basis points. A hypothetical 1.00% (100 basis points) increase in interest rates would have resulted in a decrease in the fair values of our investments of approximately \$1 million as of June 30, 2010. Such losses would only be realized if we sold the investments prior to maturity.

There have been no other material changes in our market risk during the six months ended June 30, 2010. For additional information, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in Part II of our Annual Report on Form 10-K for the year ended December 31, 2009.

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**Part I. Item 4. Controls and Procedures**

***Evaluation of disclosure controls and procedures.***

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (the Exchange Act), our management, including our Chairman and Senior Executive, Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon that evaluation, our Chairman and Senior Executive, Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

***Changes in internal control over financial reporting.***

There were no changes to our internal control over financial reporting that occurred during the quarter ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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### **Part II. Item 1. Legal Proceedings**

In the ordinary course of business, Expedia and its subsidiaries are parties to legal proceedings and claims involving property, personal injury, contract, alleged infringement of third party intellectual property rights and other claims. A discussion of certain legal proceedings can be found in the section titled "Legal Proceedings," of our Annual Report on Form 10-K for the year ended December 31, 2009 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010. The following are developments regarding such legal proceedings:

#### ***Occupancy Tax Litigation***

*City of Houston, Texas Litigation.* The City has appealed the trial court's grant of summary judgment in favor of the online travel companies and the denial of its motion for new trial.

*City of Bowling Green, Kentucky Litigation.* Plaintiff has appealed the trial court's motion to dismiss in favor of the online travel companies.

*City of San Diego, California Litigation.* In the San Diego proceeding, the city-appointed hearing officer has held in favor of the City of San Diego at the administrative level. We have appealed the decision. This action is consolidated in the Superior Court of the State of California, Los Angeles with the pending claims by the Cities of Anaheim, San Francisco and Los Angeles, and further proceedings will take place in this court.

*City of Anaheim, California Litigation.* Defendants' demurrer and motion for judgment granting claim for declaratory relief are pending before the court.

*County of Monroe, Florida Statewide Class Action.* The parties have reached a settlement in principle.

*Leon County, Florida Litigation.* The plaintiff counties in this case have sought a court order to allow the addition of five new counties to this suit.

*Orange County, Florida Litigation.* Plaintiff has moved for summary judgment. The August 23, 2010 trial date in this action has been stricken by the court.

*Columbus-Findley, Ohio Litigation.* The parties have filed cross-motions for summary judgment. Plaintiff municipalities have requested certification of legal issues to the Ohio Supreme Court.

*City of Atlanta, Georgia Litigation.* The trial court ruled on the parties' cross-motions for summary judgment. The court held that the online travel companies are not innkeepers and therefore are not subject to the Atlanta ordinance. The court held that the online travel companies are third-party tax collectors and that tax should be collected on the online travel companies' fees. The court issued an injunction requiring the online travel companies to collect and remit taxes on their fees.

*Columbus, Georgia Litigation.* The parties have filed cross-motions for summary judgment.

*City of Charleston, Town of Mt. Pleasant and City of North Myrtle Beach Litigation.* The parties have reached a settlement in principle.

*South Carolina Department of Revenue Litigation.* Oral argument was held before the South Carolina Supreme Court on Travelscape's appeal and the appeal is now under consideration by the court.

*St. Louis, Missouri Litigation.* The court denied defendant online travel companies motion to dismiss plaintiff's complaint.

*Gallup, New Mexico Litigation.* Plaintiff Municipalities have filed a motion for reconsideration of the court's denial of their motion for summary judgment.

*Goodlettsville, Tennessee Litigation.* Plaintiff's motion for class certification has been granted.

*Township of Lyndhurst, New Jersey Litigation.* Lyndhurst has requested certification to the New Jersey Supreme Court in connection with its pending appeal of the trial court's dismissal of its claims.

*County Commissioners of Worcester County, Maryland Litigation.* The parties have reached a settlement in principle.

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*County of Lawrence, Pennsylvania Litigation.* Defendant online travel companies have moved to dismiss the complaint.



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### **Part II. Item 1. Legal Proceedings**

*Pine Bluff, Arkansas Litigation.* Defendant online travel companies have moved to dismiss the complaint.

The following additional cases were filed and/or served during the second quarter of 2010:

*The Appeal of the City of Philadelphia, Pennsylvania v. Tax Review Board*, Court of Common Pleas of Philadelphia County, First Judicial District, Nos. 00764 and 00363. The City of Philadelphia has appealed the administrative decision by its Tax Review Board finding that Expedia is not obligated to pay hotel occupancy taxes to the Court of Common Pleas. The City is challenging the adverse decision of the Tax Review Board and claims that its municipal ordinance requires the collection and remittance of occupancy taxes by Expedia.

*City of Santa Monica, California v. Expedia, Inc., et al.*, Superior Court of the State of California, County of Los Angeles, West District, Case No. 108568. On June 25, 2010, the City of Santa Monica brought a suit against a number of internet travel companies, including hotels.com, Expedia and Hotwire. The City claims that internet travel companies act as independent, nonexclusive sales agents for hotels and thus are obligated to collect and remit occupancy tax on their services. The complaint includes claims for conversion, declaratory relief, violations of California Civil Code § 2223, violations of California Civil Code § 2224, imposition of a constructive trust, declaratory relief regarding application of the step transaction doctrine, and liability as agents under California Civil Code §§ 2343, 2344. This case is consolidated in the Superior Court of the State of California, Los Angeles with the pending claims by the City of Anaheim, San Francisco, San Diego and Los Angeles. Defendants' answer is due August 6, 2010.

*Town of Hilton Head Island, South Carolina v. Hotels.com, et al.*, Court of Common Pleas, County of Beaufort, Case No. 2010-CP-07-1544. On April 2, 2010, the Town of Hilton Head filed suit against a number of internet travel companies, including hotels.com, Expedia and Hotwire. The Town of Hilton Head claims that defendants have failed to collect, or collected and failed to remit or pay, beach preservation fees and local accommodation taxes. The complaint includes claims for violation of the local accommodations tax ordinance, conversion, imposition of a trust and/or constructive trust, unjust enrichment, demand for legal accounting, unfair trade practices, and civil conspiracy. Defendants' answer to the complaint is due August 2, 2010.

*Baltimore County, Maryland v. Priceline.com, Inc., et al.*, United States District Court, District of Maryland, Northern Division, Case No. MJG10CV1104. On May 3, 2010, Baltimore County filed suit against a number of internet travel companies, including hotels.com, Expedia and Hotwire. The complaint alleges that the defendants have failed to pay county hotel occupancy taxes as required by municipal ordinance. The complaint includes claims for declaratory judgment, violation of the tax code, conversion, injunctive relief, unjust enrichment/assumpsit, imposition of a constructive trust and damages. Defendants' answer to the complaint is due August 20, 2010.

At various times, the Company has also received notices of audit or tax assessments from municipalities and other taxing jurisdictions concerning our possible obligations with respect to state and local hotel occupancy or related taxes, which are listed in the section titled "Legal Proceedings" of our Annual Report on Form 10-K for the year ended December 31, 2009 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010.

The Company believes that the claims discussed above lack merit and will continue to defend vigorously against them.

*New York Litigation.* The City of New York has moved to dismiss the online travel companies' claim that the city's newly-enacted ordinance exceeds the scope of its taxing authority.

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**Part II. Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2009, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**Table of Contents****Part II. Item 6. Exhibits**

The exhibits listed below are filed as part of this Quarterly Report on Form 10-Q.

| Exhibit<br>No. | Exhibit Description                                                                                                                                                                                                                                                                                                                                  | Filed<br>Herewith | Incorporated by Reference |              |         |             |
|----------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|---------------------------|--------------|---------|-------------|
|                |                                                                                                                                                                                                                                                                                                                                                      |                   | Form                      | SEC File No. | Exhibit | Filing Date |
| 31.1           | Certification of the Chairman and Senior Executive Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                         | X                 |                           |              |         |             |
| 31.2           | Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                               | X                 |                           |              |         |             |
| 31.3           | Certification of the Chief Financial Officer pursuant Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                  | X                 |                           |              |         |             |
| 32.1           | Certification of the Chairman and Senior Executive pursuant Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                            | X                 |                           |              |         |             |
| 32.2           | Certification of the Chief Executive Officer pursuant Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                  | X                 |                           |              |         |             |
| 32.3           | Certification of the Chief Financial Officer pursuant Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                  | X                 |                           |              |         |             |
| 101*           | The following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, formatted in XBRL: (i) Consolidated Statements of Operations, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements, tagged as blocks of text. |                   |                           |              |         |             |

\* Furnished herewith.

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**Signature**

Pursuant to the requirements of the Section 13 or 15(d) Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

July 29, 2010

Expedia, Inc.

BY:

/s/ MICHAEL B. ADLER  
**Michael B. Adler**  
**Chief Financial Officer**